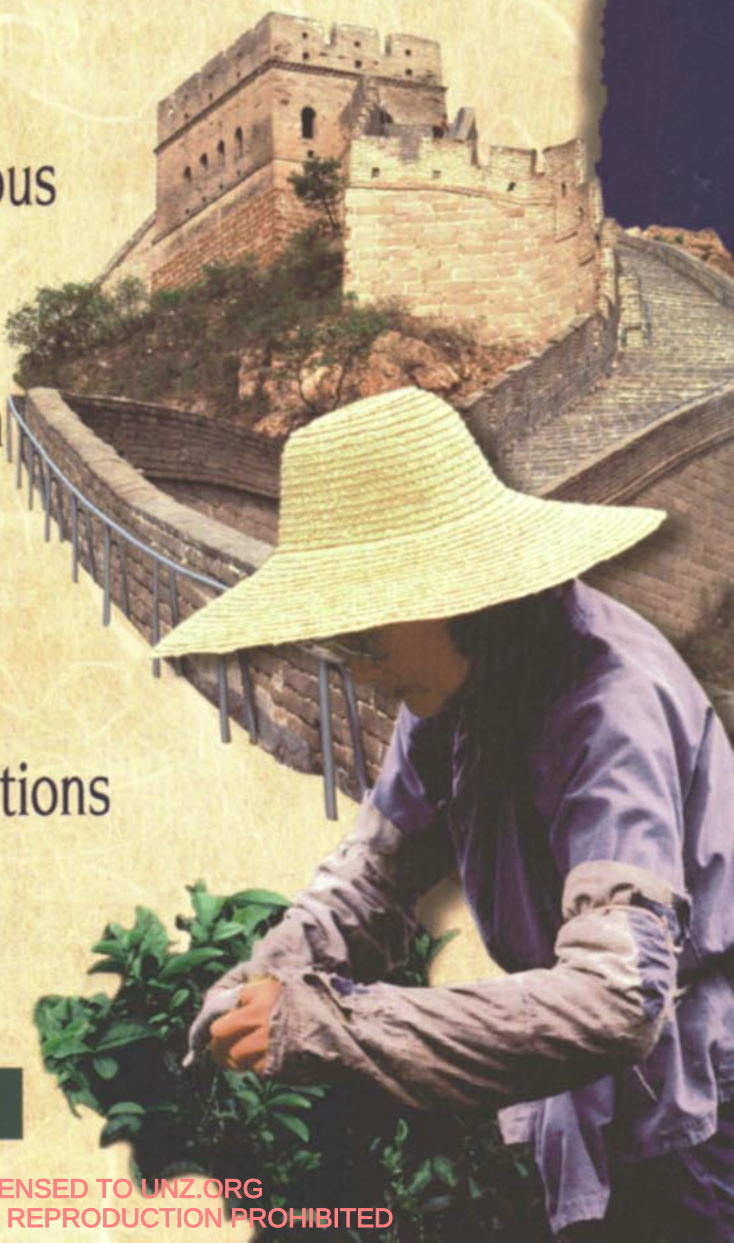
THE FREEMAN

Ideas On Liberty



- China's Spontaneous Order
- Wasting Energy on Energy Efficiency
- Opportunity Cost and Hidden Inventions
- Recycling Labor

APRIL 1999

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

FEE Summer Seminars

Join us and reach for the stars!

Imagine spending five days talking about ideas with people who care deeply about freedom. Imagine getting to know people from around the United States and from other countries and forming friendships that could last a lifetime. Imagine staying at a century-old Victorian estate that is a short train ride away from New York City. These images are just a part of what a FEE Summer Seminar is about.

What else are our seminars about? They're about changing the way you think about the world. They're about giving you tools that will help you understand and explain how the economy and our political system work. They're about giving you new insights into history. They're about freedom, free markets, and the power of individuals to build a better world.

This summer FEE holds two five-day seminars. Why not join us? Or send a child, grandchild, or friend — and have the experience of a lifetime! Costs for the week, which includes room, board, and materials, are $450. Scholarships are available.

Introductory Seminar in Economics, Politics & History, June 26 - July 1, 1999

Spend five days discussing basic economic principles, such as the causes of wealth, prices, trade, money, and regulation. Investigate the history of individual rights and property rights. See what's wrong with most analyses of the Great Depression. Talk about the environment, the market and technology, and government schooling.

Join: Dr. Don Boudreaux, President of FEE; Mr. Sheldon Richman, Editor of The Freeman; Dr. Richard Timberlake, University of Georgia; Mr. Doug Bandow, The Cato Institute and others for an intensive introduction to free-market economics and the principles of liberty.

Advanced Seminar on the Economics and Ethics of the State, August 7 - August 12, 1999

Do we need a central bank, a government monopoly over the money supply? Who does a better job of protecting the environment: private parties or the EPA? Should Microsoft be sued for antitrust violations? Does government promote discrimination? Our speakers discuss these and other timely issues.

Join: Dr. Don Boudreaux; Mr. Clint Bolick, Institute for Justice; Dr. Roger Meiners, University of TX, Arlington; Dr. Andrew Morriss, Case Western Reserve Law School and others for an intensive look at the pitfalls of government regulation and the alternative: market-based solutions.

It's going to be a great summer — come and see why!

For applications, call 800.452.3518, fax 914.591.8910 or email kboudreaux@fee.org, or write to us at FEE, 30 South Broadway, Irvington-on-Hudson, NY 10533.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty
April 1999 Vol. 49, No. 4

FEATURES

8 **Recycling Labor** *by Charles W. Baird*
13 **Scientists Beware** *by Bruce L. Benson*
18 **Wasting Energy on Energy Efficiency** *by Ben Lieberman*
22 **Paper Tiger** *by Christopher Mayer*
24 **China's Spontaneous Order** *by James A. Dorn*
30 **The Commons: Tragedy or Triumph?** *by Bruce Yandle*
35 **Second-Guessing the Market** *by John A. Sparks*
37 **Money in the 1920s and 1930s** *by Richard Timberlake*
45 **James F. Lincoln: Industrial Peacemaker** *by Daniel Hager*
48 **Withholding the Taxpayer Hostage** *by Donald J. Boudreaux and Andrew P. Morriss*
52 **I Lost My Job—Can I Keep My Principles?** *by Mark Reboul*

COLUMNS

4 *THOUGHTS on FREEDOM*—**Who's Progressive?** *by Donald J. Boudreaux*
16 *IDEAS and CONSEQUENCES*—**Flunking Economics** *by Lawrence W. Reed*
28 *POTOMAC PRINCIPLES*—**Think Tank Wars and the Minimum Wage** *by Doug Bandow*
43 *PERIPATETICS*—**Inscrutable Follies** *by Sheldon Richman*
50 *ECONOMIC NOTIONS*—**Opportunity Cost and Hidden Inventions** *by Dwight R. Lee*
53 *ECONOMICS on TRIAL*—**The Battle for Diamond Head: A Case of Market Failure?** *by Mark Skousen*
63 *THE PURSUIT of HAPPINESS*—**What American Education Needs** *by Walter E. Williams*

DEPARTMENTS

2 **Perspective—"Security" or Friedman** *by Sheldon Richman*
6 **"So-Called Property Rights"? It Just Ain't So!** *by Roger Meiners*
55 **Book Reviews**

The Future and Its Enemies by Virginia Postrel, reviewed by George C. Leef; **The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor** by David S. Landes, reviewed by Randall G. Holcombe; **From Wealth to Power: The Unusual Origins of America's World Role** by Fareed Zakaria, reviewed by Robert Higgs; **American Abundance: The New Economic and Moral Prosperity** by Lawrence A. Kudlow, reviewed by William H. Peterson; **Africa in Chaos** by George B. N. Ayittey, reviewed by Mwangi S. Kimenyi; **Swimming Against the Tide** by Clarence B. Carson, reviewed by Norman S. Ream.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533
Phone (914) 591–7230 FAX (914) 591–8910
E-mail: freeman@fee.org
FEE Home Page: http://www.fee.org

President: Donald J. Boudreaux

Editor: Sheldon Richman

Managing Editor: Beth A. Hoffman

Editor Emeritus
Paul L. Poirot

Book Review Editor
George C. Leef

Editorial Assistant
Mary Ann Murphy

Columnists
Charles W. Baird
Doug Bandow
Dwight R. Lee
Lawrence W. Reed
Mark Skousen
Walter Williams

Contributing Editors
Peter J. Boettke
Clarence B. Carson
Thomas J. DiLorenzo
Burton W. Folsom, Jr.
Joseph S. Fulda
Bettina Bien Greaves
Robert Higgs
John Hospers
Raymond J. Keating
Daniel B. Klein
Wendy McElroy
Tibor R. Machan
Ronald Nash
Edmund A. Opitz
James L. Payne
William H. Peterson
Jane S. Shaw
Richard H. Timberlake
Lawrence H. White

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533. FEE, established in 1946 by Leonard E. Read, is a non-political, educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501(c)(3) tax-exempt organization.

Copyright © 1999 by The Foundation for Economic Education. Permission is granted to reprint any article in this issue, provided credit is given and two copies of the reprinted material are sent to FEE.

The costs of Foundation projects and services are met through donations, which are invited in any amount. Donors of $30.00 or more receive a subscription to *The Freeman*. For foreign delivery, a donation of $45.00 a year is suggested to cover mailing costs. Student subscriptions are $10.00 for the nine-month academic year; $5.00 per semester. Additional copies of this issue of *The Freeman* are $3.00 each.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1972 to date. *The Freeman* is available in microform from University Microfilms, 300 N. Zeeb Rd., Ann Arbor, MI 48106.

PERSPECTIVE

"Security" or Friedman

True joy is waking up to a Milton Friedman op-ed. He never quits. In January the *New York Times* published his article "Social Security Chimeras." What a breath of fresh air!

Milton Friedman begins by criticizing the increasingly common suggestion that individual accounts replace *part* of each person's Social Security benefits. "Why replace only *part* and not *all* of Government benefits?" he asks. He goes on to refute the response that the government needs the money to pay current retirees.

Friedman's op-ed really shines when he demolishes the case for a *mandatory* privatized system. As advocated by economist Martin Feldstein and others, everyone would be forced to save a minimum amount specified by the government. Feldstein says that's necessary because, "First, some individuals are too shortsighted to provide for their own retirement [and] second, the alternative of a means-tested program for the aged might encourage some lower-income individuals to make no provision for their old age deliberately, knowing that they would receive the means-tested amount."

Friedman's response:

> [T]he fraction of a person's income that it is reasonable for him or her to set aside for retirement depends on that person's circumstances and values. It makes no more sense to specify a minimum fraction for all people than to mandate a minimum fraction of income that must be spent on housing or transportation. Our general presumption is that individuals can best judge for themselves how to use their resources. Mr. Feldstein simply asserts that in this particular case the Government knows better. . . . I find it hard to justify requiring 100 percent of the people to adopt a Government-prescribed straitjacket.

Friedman ends by calling for a voluntary pension system. (In one sense, it would still be compulsory; we'd be taxed to support people

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

now on Social Security.) "I believe that the ongoing discussion about privatizing Social Security would benefit from paying more attention to fundamentals," Friedman said, "rather than dwelling simply on nuts and bolts of privatization." Hear, hear!

* * *

Corporate layoffs make for good, glitzy television-news reporting. The addition of jobs is dry and statistical. No wonder people have a sense that layoffs outnumber new jobs. Charles Baird looks at the facts and finds a whole different picture.

Richard Cobden once pointed out that when government touches something—he had trade and religion in mind—it's twisted into something else entirely, and not for the better. Bruce Benson demonstrates that science can be added to Cobden's list.

The energy crisis, a production of your government, is long gone, but the regulations designed to whip us into efficient energy users live on. Worse, we get new ones all the time. Ben Lieberman shows the lengths to which such inanity can go.

If you lived through that crisis, you might have thought the future would be an eternal nightmare compliments of oil sheiks and—these letters were scarier than "IRS"—OPEC. Since then the price of a gallon of gas has fallen below the price of a gallon of milk. What happened to the big bad cartel? Christopher Mayer will fill you in.

What is really happening in China? Is it going capitalist even as it defends the socialist revolution? Why is it jailing dissidents? James Dorn brings lucidity to the enigma.

The term "the tragedy of the commons" has become a cliché, useful to free-market advocates as well as statist environmentalists in promulgating their policy views on property and ecology. Bruce Yandle explores how tragedies can become triumphs.

The welfare state doesn't miss a trick. Under President Bush, the Commerce Department started a program to subsidize private companies in the development of new technology. You see, markets aren't good at that and—well, John Sparks will give you the scoop on this creative piece of governance.

During the 1920s, the monetary authority did *something* to set the stage for the economic debacle of the 1930s. But *what*? The literature is full of conflicting answers. Richard Timberlake sorts it all out in the first of a series of articles.

Labor-relations law is premised on the Marxist notion of an irreconcilable conflict between workers and employers. Economists have debunked the notion, and so have some businessmen. Daniel Hager tell us about one: James F. Lincoln.

The withholding tax is a classic case of adding insult to injury. It's bad enough the government appropriates a chunk of our income; but it does so before we even see it. Donald Boudreaux and Andrew Morriss point out that withholding is more than just an insult.

If you tell people you don't *want* government benefits you are "entitled" to, people sure look at you funny. That's what Mark Reboul found out when he was laid off.

FEE president Don Boudreaux's monthly *Notes from FEE* column moves to the front of the magazine beginning this month. In other columns, Lawrence Reed reports on a new study about high-school economics texts, Doug Bandow dissects the minimum wage, Dwight Lee exposes the "hidden technology" myth, Mark Skousen wonders about Diamond Head and property rights, and Walter Williams takes on the government schools. Roger Meiners looks at what William Weld has to say about property rights and the environment and implores, "It Just Ain't So!"

Our book reviewers examine tomes on conflicting outlooks about the future, the wealth and poverty of nations, America's role in the world, the economy ahead, misery in Africa, and the memoirs of Clarence Carson.

—SHELDON RICHMAN

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Thoughts on Freedom

by Donald J. Boudreaux

Who's Progressive?

Our world is full of grotesque mislabeling—for example, politicians are called "Honorable." Few labels, though, are as inappropriate as is the term "progressive" when it is used, as it frequently is, to describe people who endorse widespread government regulation. "Progressivism" came into use in late nineteenth-century America as the label for a naïve yet ambitious program for giving the government carte blanche control over the economy. To this day, American leftists (mostly of an academic bent) snootily declare themselves and their policies to be "progressive."

But you don't turn junk into jewels by calling it pearls. No matter what they *call* themselves, statists emphatically are not progressive. The root word of "progressive" is "progress," which my Merriam-Webster defines as "to move forward" and "to develop to a more advanced stage." Under this definition, statists are *anti*-progressive; they're *re*gressive; they possess less ethical sophistication than Cro-Magnon man.

Think about it. The statists' policy prescriptions are nothing but directions for the use of force. From dealing with the poor ("force the haves to surrender some of their money to the have-nots") to the regulation of industry ("force every firm to abide by bureaucratic rules") to cultural matters ("force people to support art that they will not buy voluntarily"), the common element in all statist proposals is force—coercion, or its threat, initiated against peaceful people.

What, though, is more primitive, more backward, more *re*gressive, than relying on force as a means of organizing society? Relying on force requires no intelligence, ingenuity, insight, or wisdom. If you have more brains than a tree stump, you can visualize how to satisfy your immediate desires through force—simply grab whatever you want, standing ready to bludgeon or blast away anyone who interferes with you. And if what you want is someone else's services, simply threaten to do him physical harm unless he does your bidding.

Coercion and theft are primal impulses, and primal impulses become no more meritorious when carried out by government officials than when carried out by lone bandits.

Consent and Empathy

Compare reliance on force with reliance on voluntary, peaceful actions. A bandit—be he an independent operator or an agent of government—is interested in his victim's thoughts and desires only insofar as these determine if and how the victim will defend himself.

In contrast, peaceful people identify with—empathize with—one another. They must figure out other people's likes and dislikes, needs and turn-offs—for only by empathizing with others can they prosper in the market. They must learn what to offer in order to prompt others to exchange goods and services with

---

Donald J. Boudreaux is president of FEE.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

them. The entrepreneur who stubbornly ignores the desires of consumers and insists on producing only what he, personally, likes will not long remain an entrepreneur.

This reciprocal learning in the market is continual. Far more than anything that government does, this process of being attentive to the needs of one another is what links us together into a peaceful and prosperous society.

Moreover, while force destroys, market relations create. The brute who steals my supper gives me nothing in return; his gain is my loss. And because I will not long keep producing if others keep stealing from me, coercion literally destroys wealth. But as I said, in the market people gain only by offering things of value. Human beings—brimming as we are with creativity—produce value by devising new products, new services, and new ways of doing worthwhile tasks. The more we create for exchange, the better off we all are.

Creativity, by its nature, is truly progressive. So, too, are the social conditions that promote creativity: private property rights, the division of labor governed by market prices and voluntary choice, and the rule of law under which no one is accorded special privileges or duties. While some semblance of private property rights and the division of labor has always been part of human societies, these institutions remain stunted and distorted without the rule of law. Regrettably, the rule of law has been largely absent from human history. It flowered during the Roman republic and again in western Europe during the past few centuries, reaching its historical zenith in nineteenth-century England and America.

Tragic Retreat

But we've drawn back from the rule of law during this century. Government increasingly treats us according to which groups we belong to rather than according to our individual actions. A new caste system is in the works. But pigeonholing people into various groups, and distributing legal privileges and duties accordingly, is primitive. Such obsession with status is a hallmark of the most repressive and backward of societies. The gall of the proponents of this new caste system to call themselves "progressive"!

The countless generations of human beings who lived before the industrial revolution knew very little prosperity and progress. With the exception of the nobility and a select few other fortunate dandies, people lived in uniform poverty and misery. (Indeed, even the nobility and the few fortunate dandies lived in what by our standards is deep poverty.) Hunger, disease, filth, and boredom—not to mention the deaths of spouses, siblings, and children—were routine and inescapable features of life.

Only since the protection of property rights and freedom of contract became widespread and available to the humblest person did the human race yank itself from the muck. Only then did we prosper and flourish. We did so because these institutions dramatically reduced the scope for "legitimate" force and therefore inspired us instead to create and to deal with one another peacefully and as equals, rather than as masters and slaves.

As Tom Bethell shows in his wonderful new book, *The Noblest Triumph*:

> When property is privatized, and the rule of law is established, in such a way that all including the rulers themselves are subject to the same law, economies will prosper and civilization will blossom. Of the different possible configurations of property, only private property can have this desirable effect.

Some proponents of government intervention in economic affairs fail to see that force only destroys and never creates, while others are power-hungry hooligans. None of them, however, are progressive. True progressives embrace private property rights, the free market, and the creativity and advancement that these institutions let loose. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

"So-Called Property Rights"?

It Just Ain't So!

Remember William Weld? He was the Massachusetts governor (and presumed presidential wannabe), who resigned so President Clinton could appoint him to dispense advice as ambassador to Mexico. Those plans were derailed by Senator Jesse Helms, so now he makes money in Boston perhaps while planning his political future. Weld wrote an op-ed in the *New York Times* late last year that indicates why the media like this "maverick" Republican. In "Government Made Easy," Weld skewers the leading Republican and Democratic presidential aspirants because, unlike the with-it Weld, they "really don't get it."

In a couple of paragraphs, Weld tries to position himself as a thoughtful guy who understands the virtues of markets by attacking nationalized health care, wage and price controls, and collective bargaining by public school employees. He is also foursquare against slavery—really. Tough stuff in Massachusetts.

What role does he see for government? It is to appeal "to the better angels of our nature, when it contributes to a sense of community, both at home and abroad." How does it do this? By, among other things, strong environmental controls. Let's focus on only a few of his pronouncements to see the depth of his lack of knowledge of markets and law.

Weld asserts that "Individuals and businesses simply will not protect the environment for our descendants; we need vigorous government enforcement and conservation measures." He scorns "backers of so-called property rights."

He does not understand that property rights are the key to environmental protection. People, not government leaders, protect resources, environmental or otherwise. The worst abuses of the environment in the United States have come on government-controlled lands. The communists left an environmental nightmare behind in Russia and other eastern European countries.

The Virtue of Property

Weld's mistake is common. It is one that Tom Bethell discusses brilliantly in his new book, *The Noblest Triumph: Property and Prosperity Through the Ages*. Those who do not understand the virtues of liberty and markets, as exemplified by private property, believe that problems can best be overcome by having the right person in charge. Sure, dolts like Stalin and Brezhnev got it wrong and ruined the environment (and everything else); if only there had been a *good* person in charge. . . . The Russians needed someone who knew how to exploit "the better angels of our nature," as Weld says. Unfortunately, heaven on earth is not possible; Weld could not produce it in Massachusetts—good luck on a larger scale.

In any event, Weld need not worry about individuals and businesses destroying the environment—it was nationalized in the early 1970s when the EPA was created and given near total control over environmental matters. But in recent decades politicians have fared well by perpetuating the myth that centralized control of the environment is needed to save it. The Al Gores and William Welds of the world will save us from our ecologically destructive selves!

Weld thinks people can "pursue happiness" when the government is there to help them do so. Of course, it is the other way around. People naturally pursue happiness. Government "helps" that to happen not by centralized control of the use of property but by helping to protect and enforce private property rights.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Weld's lack of respect for the fundamental legal regime that allowed this nation to be so successful is astonishing. Besides deriding the fundamental liberty of property rights, he also says we should "not give ourselves over to generalized weeping about due process." Toss out the Constitution.

Weld also focuses on the need for strong antitrust laws. After all, he notes, "government is good when it safeguards our livelihoods from predatory business practices." As a former Federal Trade Commission bureaucrat, I can report that businesses often engage in "predatory business practices." Over and over, we see businesses attempting to gain market share at the expense of their competitors!

Many practices are used in an effort to lure customers from one seller to another: new product innovations, quality improvements, price reductions, and advertising. What is predation to a losing firm is usually another firm's superior service to the public. Don't like UPS? Switch to Fed Ex or DHL. Don't like the Department of Justice? Switch to, uh, well, just trust Weld to put the right person there to produce good government.

Weld's concern about "predation," which most people presume to mean really nasty business tactics—the evil stuff shown in so many television shows and movies—is belied by the dearth of cases. Even the Clinton regulators find so little to pick on that they are reduced to the foolishness of devoting public resources to beating up on Microsoft: one multibillion dollar company giving away its Web browser to lure customers from the market-dominant browser of another multibillion dollar company. They even have tape recordings of Bill Gates saying that he wants to beat the competition!

Weld hits the nail on the head when he notes that "Economic Man will take the whole pie for himself every time, if you let him." That, in straightforward language, is in fact an essential assumption in economic theory. Theory assumes that people are interested in maximizing their own well-being. Much of this has to do with obtaining wealth for personal and family comfort, but it goes far beyond that. Well-known people often derided as Robber Barons—Carnegie, Ford, and Rockefeller—earned billions! And what became of their wealth? It was mostly given to charity.

Humans are inherently competitive. That drive can be exploited largely for good and productive purposes, such as devising better products that help people, or it can be devoted to wheedling resources out of the pockets of those who worked to earn them. One can be a thief, which is clearly unproductive to society. One can also be a politician who exploits the power of government to force people to give up earned resources to those who are wise enough to support the politician.

Perhaps I have been overly harsh. Weld is not a deep thinker. Like many politicians he probably sincerely believes he can tell us what to do to live a better life. He has the same instincts as George Bernard Shaw, who believed that the Soviets were doing a great job of crafting a "new man" devoid of self-interest.

When the Berlin wall fell, the crust finally fell from most people's eyes about the real nature of central control. Not William Weld's. He still does not get it. The Mexican people can count their lucky stars.

—Roger Meiners
University of Texas, Arlington
Senior Associate, PERC
meiners@uta.edu

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Recycling Labor

by Charles W. Baird

In 1998 Boeing and MCI WorldCom, to mention only two, announced plans for massive layoffs. Boeing actually cut 48,000 jobs. Throughout 1998 there were many announcements of intended mergers—for example, Exxon with Mobil and Chevron with Shell—most of which included plans for substantial job cuts. Total layoff announcements in the United States in 1998 exceeded 600,000.

To those who received such announcements it must have seemed that their personal fortunes were ruined and the economy was falling apart. No one wants to leave a job involuntarily, and when one hears of it happening, one is naturally sympathetic. The perceived instability of employment in free-market economies is a major reason why many Americans support government intervention in the labor market.

Yet in any market-based economy there will always be layoffs and there will always be hires. Moreover, this is to be celebrated. It is a sign of economic health. Given the pace of change in what we know, in what is discovered to be possible, in consumer tastes and preferences, and in the extent of competition, labor, like all productive resources, must constantly be recycled.

The popular press always stresses the downside of the recycling of labor. Bad news sells better than good news and each plant closure or massive layoff is easy to capture on videotape. The upside of recycling—the hiring—is more diffuse and less visible. Nevertheless, most of the time the upside outweighs the downside.

From December 1997 to November 1998, in spite of all the layoffs and downsizing that occurred, entrepreneurs in the American economy created over a million and a half *net* new jobs. That's an average of 131,916 more jobs created than lost each month. And 1998 was not unusual. Table 1, column 2, shows this net job creation (December to November, seasonally adjusted) in each year starting in December 1992. Column 3 shows the 12-month diffusion index of employment change for the same periods. A diffusion index of 50 percent indicates an equal number of American industries adding and decreasing jobs.

TABLE 1

Year	Net New Jobs	Diffusion Index
1992	1,106,000	62.9
1993	2,293,000	69.2
1994	3,362,000	66.6
1995	672,000	63.5
1996	2,543,000	69.1
1997	2,825,000	72.9
1998	1,583,000	n.a.

Source: http://www.bls.gov/news.release/empsit.toc.htm (Bureau of Labor Statistics Employment Situation Report)

Charles Baird is a professor of economics and the director of the Smith Center for Private Enterprise Studies at California State University at Hayward.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In every year net new jobs were created, and more industries added than eliminated jobs. Clearly, layoffs and downsizing do not mean the American economy is falling apart.

Moreover, the personal fortunes of most people who receive layoff notices are not ruined. Most find new jobs at better pay after a job search and relocation. Table 2, column 2, shows the American unemployment rate, and column 3 shows the median duration of unemployment in November for each year from 1992 to 1998. Column 4 shows the private-sector employee total compensation index for the third quarter of each year. For example, in the third quarter of 1998 total compensation paid to private-sector employees was 38.7 percent higher than in the second quarter of 1989. Total compensation includes wages and salaries plus all benefits such as health insurance and paid vacations.

TABLE 2

Year	Unemployment Rate (percent)	Median Duration (in weeks)	Compensation Index (1989/2=100)
1992	7.4	9.0	114.7
1993	6.6	8.3	118.9
1994	5.6	9.1	122.8
1995	5.6	8.1	126.1
1996	5.4	7.8	129.7
1997	4.6	7.8	133.7
1998	4.4	6.7	138.7

Source: http://www.bls.gov/news.release/empsit.toc.htm

Using Bureau of Labor Statistics (BLS) data, the Employment Policy Foundation concluded that in the last five years, average annual employment growth in the highest paid one-third of new jobs was 3.2 percent. In the same period, employment growth averaged just over 1 percent in the lowest- and middle-paying thirds. This means that over 60 percent of all employment growth occurred in jobs in the top third.[1] Since 1983, job growth in the top third has been 50 percent, which is one-and-a-half times more than in the lower third.[2] It seems clear that for most people who receive layoff notices, unemployment is temporary and a bridge to a better job.

The unemployed fall into four categories: job losers, job leavers, re-entrants, and new entrants to the labor market. The job losers are those who are fired, those who receive layoff notices, and those who have completed a temporary job. Job leavers are those who choose to quit a job either to take or to seek another job. Re-entrants are people who were employed in the past but who dropped out of the active labor force for some time to pursue other activities, such as school or homemaking, and who then take up an active job search. New entrants are those who are engaging in active job search for the first time.

Table 3 shows the percentage distribution of the unemployed in each of the four categories in November in the years 1992 to 1998. Job losers are the largest group, followed by re-entrants.

TABLE 3

Year	Job Losers	Job Leavers	Re-Entrants	New Entrants
1992	55.2%	10.5%	24.0%	10.3%
1993	52.5	11.9	25.2	10.4
1994	48.0	9.5	34.5	8.0
1995	47.6	11.1	33.4	7.8
1996	45.9	11.4	34.6	8.1
1997	45.6	10.3	35.2	8.8
1998	45.0	10.7	35.4	8.9

Source: http://www.bls.gov/news.release/empsit.toc.htm

Job leavers and new entrants together make up roughly 20 percent of the unemployed. In November 1998 the seasonally adjusted number of unemployed people was just over six million. So there were about 2.7 million job losers, three-quarters of a million job leavers, over 2 million re-entrants, and over half a million new entrants. They were all actively involved in the labor recycling process.

Another way to think of employment and unemployment is as percentages of the total civilian noninstitutionalized population aged 16 or over (hereinafter, the population). The unemployment rate reported above is the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

number of unemployed divided by the active labor force. The active labor force is the sum of the employed and the unemployed. Only people who are out of work and who are actively seeking work are counted as unemployed. Many people in the population are not in the active labor force. The labor-force participation rate is the active labor force divided by the population. Table 4, column 2, shows the labor force participation rate in November of the years 1992–1998. Column 3 shows the ratio of the employed to the population. The difference between columns 2 and 3 in any year is the ratio of the unemployed to the population. Those ratios are shown in column 4. In November 1998, for example, only 3 percent of the entire population was unemployed. The other 97 percent were either employed or were not seeking employment. Since 1994, when the BLS began to collect the data, only 0.5 percent of those out of the labor force were discouraged about finding work. The rest were out of the labor force by choice.[3] Typically the discouraged job seekers are those whose skills have become obsolete and who need retraining.

TABLE 4

Year	Participation Rate	Employed/ Population	Unemployed/ Population
1992	66.3%	61.4%	4.9%
1993	66.3	61.9	4.4
1994	66.8	63.0	3.8
1995	66.5	62.8	3.7
1996	67.0	63.4	3.6
1997	67.1	64.0	3.1
1998	67.1	64.1	3.0

Source: http://www.bls.gov/news.release/empsit.toc.htm

The Market Process

The labor market, like any other market, is a process of interaction between forces of demand and supply. The buyers of labor are employers, and the sellers of labor are job seekers and job holders. When employers "buy" labor, they hire the productive services of workers. Labor is employed, along with materials, supplies, and the services of capital goods, to produce output that employers in turn sell to customers. Workers supply labor services to employers in exchange for wages, salaries, and benefits.

The maximum amount that an employer is willing to pay for a worker's services is called his demand price for the labor. It depends on the increment to output that the services make possible and on the prices for which the employer can sell the additional output to customers. Suppose that employer expects that an additional worker makes possible the creation of ten additional units of output per day, and that when those units are sold, the employer will receive $120 of extra revenue net of all other incremental costs. The hiring cost is the sum of compensation paid to the worker and employment taxes paid to government. The employer would not be willing to pay $120 per day or more for the worker's services, but at any hiring cost less than $120 per day, the employer would increase profits by hiring the worker. From the employer's point of view, the lower the hiring cost the better so long as he can hire the quantity and quality of labor he wants. The lower the hiring cost, the more eager the employer will be to hire additional workers if he can get them.

If workers' productivity declines because of, for example, a change of technology that makes their services less important, or if the prices that the employer receives from customers decline because, for example, the customers decide they want to buy different products, the employer would have to cut labor costs by layoffs or by reducing rates of compensation (or both). The latter is likely to cause many workers to quit because they have no reason to think that the reduced compensation is the best they can do. Both those laid off and those who quit will begin a process of job search.

The minimum compensation that an employee will accept from an employer is called his supply price for the job. It depends on his perception of his alternative employment (and unemployment) opportunities. Other things equal, the better his alternatives the higher his supply price. If you know you can get $15 per hour from Employer X for doing a job, you will not accept anything less from Employer Y for doing the same job. If

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

your alternative to working for Employer X is to be unemployed (a very unlikely situation), you will have a higher supply price if your family will support you during unemployment than you will if your best alternative is to become homeless.

So there is an upper limit on what an employer will pay and a lower limit on what a worker will accept. The actual rates of compensation depend on the relative strengths of two types of competition in the relevant labor market—competition among employers to hire and competition among employees to be hired. For a given level of competition among employees, the more intense the competition among employers to hire, the greater the pay. Conversely, for a given level of competition among employers to hire, the greater the competition among employees, the lower the pay. Every hiring of every worker is an employment contract based on voluntary exchange. Every employer and every employee enter into such contracts because they expect to be better off than they would be if they did not do so.

From an individual worker's point of view, the best of all possible situations is to be the only one who can do a particular kind of work and to have hundreds of employers competing to hire someone who can do the job. Such a worker would have tremendous bargaining power, and any one employer would have almost no bargaining power. Similarly, from an individual employer's point of view, the best of all possible situations is to be the only buyer of a particular kind of labor service and to have a plethora of workers competing to do the job. Such an employer would have tremendous bargaining power, and any one worker would have almost no bargaining power. Bargaining power in any market depends on the alternatives available to the actors therein.

Enterpreneurship

Entrepreneurs are the key actors in all markets. The role of an entrepreneur is to discover and grasp profit opportunities. Every problem that emerges in a market is a profit opportunity for an entrepreneur who first notices how to solve it and undertakes the solution. Successful innovations by entrepreneurs elicit imitation, and imitation by more and more people means that, in free-market settings, problems inevitably give way to solutions. Entrepreneurs do what they do in pursuit of profit; but when they are successful, and therefore make profit, the rest of us benefit from their innovations.

Entrepreneurship involves creating new products, creating new technologies, creating new productive resources, assembling new combinations of productive resources to produce old and new products, adopting new forms of organization, and entering new markets and exiting old ones. Buyers and sellers in all markets must keep abreast of more innovation now than ever before. In today's markets, successful innovation at one place rapidly affects most other places. Entrepreneurship, and responses to entrepreneurship, lie behind the recycling of labor (and of other productive resources).

Suppose that the proposed merger of Exxon and Mobil takes place. In the face of falling prices for petroleum and its products (which itself is due to successful innovations in the discovery, production, and refining of crude oil as well as the discovery and implementation of alternative energy sources), the decision-makers in the new firm will have to cut out duplicative operations. This means that many employees of the merged firm will receive layoff notices. Perhaps some will be able to stay on by agreeing to accept cuts in compensation, but most will quite reasonably think that it is possible to find other satisfactory jobs that pay as much or more as the ones they have lost. While searching for alternatives, they will be counted by the BLS as unemployed. Some will find new employment quickly; others will not. As noted, the median duration of unemployment in November 1998 was 6.7 weeks. If after some initially planned search period, some job seekers find no satisfactory new jobs, they will reevaluate their prospects and lower their supply prices. Or perhaps they will become convinced that their best strategy is to undertake retraining so they can find different sorts of jobs.

Employers in markets for new products and products for which customer demand is rising also engage in search. They search for new

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

employees who can do what needs to be done. They could attract a lot of applicants right away by offering very high pay and benefits, but most will reasonably think it would be cost-effective, at least for awhile, to offer normal compensation and spend some time sampling the workers that apply. Recycling labor is not a simple matter of throwing all applicants into a common bin. They must be sorted according to abilities, interests, and costs. If after some initially planned period of search the employers do not find enough satisfactory employees, they will then offer better compensation to attract more applicants.

The key insight is that every unemployed worker who wants to work is a potential profit opportunity for an entrepreneur who discovers ways of employing him. Even workers who have a hard time finding new work are potential profit opportunities. They are likely to be available at modest levels of compensation, making it cost-effective to hire and train them. And when they are trained they acquire additional bargaining power with their employers and with potential new employers. This is why, in a market-based economy, layoffs do not usually result in a growing number of unemployed people and falling average rates of compensation. Unemployment is like a pipeline. There are always people entering the pipeline, but there are always people exiting too. Even if the number of people in the pipeline at any moment were always the same, the faces on those people would be constantly changing.

Entrepreneurs, like all people, make mistakes. Some entrepreneurs think they perceive profit opportunities and hire additional labor to try to grasp those opportunities. When losses instead of profits emerge, they have to pass out layoff notices. However, the historical record suggests that under normal circumstances, entrepreneurial successes more than make up for entrepreneurial failures. After all, entrepreneurs are self-interested and therefore keenly motivated to avoid mistakes and the losses that result.

Of course, there are occasional periods during which unemployment increases relative to employment, but these are the result of faulty government policies that cripple the labor recycling process. If, for example, the government inflates the money supply and thus distorts the price signals to which entrepreneurs respond, lots of entrepreneurs will hire labor that later, after the market corrects the distorted prices, they will have to lay off. Excessive taxation and regulation are other ways in which government can cripple the labor recycling process.

Government Doesn't Create Jobs

It is entrepreneurship in the context of freedom, not government, that creates increasing employment opportunities. Try to imagine what would happen to the labor-recycling process if entrepreneurs had to get permission from some government authority before they could enter or exit markets, expand or contract employment, create new products, change technologies, or alter their organizational structures. The pattern of production would become less and less consistent with the pattern people want. Innovation would shrivel. Lots of people would continue to be employed doing what they always did, but they would increasingly produce things for which there would be no demand. There would be few job opportunities for new people in the labor force. Production would be aimed at keeping government authorities, not customers, happy.

American presidents like to assert that they are elected to "run the economy." We should be grateful that that is merely their conceit. No one runs a successful economy. Its success depends on no one's being in charge of it all. At the same time, its success depends on everyone's being in charge of his own production and exchange activities, dealing with others on the basis of voluntary exchange. □

1. *The American Workplace 1998* (Washington, D.C.: Employment Policy Foundation [www.epf.org], 1998), p. 24.
2. *Economic Bytes,* Employment Policy Foundation, November 2, 1998.
3. http://www.bls.gov/news.release/empsit.toc.htm, Table A-10.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Scientists Beware

by Bruce L. Benson

Many political commentators lament the growing apathy among the voting-age population, but I do not believe apathy keeps many potential voters away from the polls. Many of us care a lot about what politicians are doing; we just don't trust any of them.

Richard Nixon, Lyndon Johnson, Bill Clinton, and hundreds of others like them elected to federal, state, and local offices have destroyed the credibility of politicians in general. And this political disease is contagious. I regret to say that it has spread to my profession. So many economists have been pulled into the political process as government employees or paid consultants to provide "expert" opinions on virtually every side of every political debate that economics has lost much of its credibility. In fact, there are almost as many economist jokes as lawyer jokes (check out netec.wustl.edu/JokEc.html).

Economics is, of course, a social science (or in some circles, a "soft science"), so our laboratory is the complex real world and it is relatively easy to find selective evidence in support of any political position. The physical sciences (or "hard sciences") are not immune from the political disease either, however. The policy process at the Environmental Protection Agency has made this abundantly clear. For instance, last year while invalidating part of a 1993 EPA report on secondhand tobacco smoke, a federal judge concluded that the "EPA publicly committed to a conclusion before research had begun, . . . adjusted scientific procedure and scientific norms to validate the Agency's public conclusion, and aggressively utilized authority to disseminate findings to establish a de facto regulatory scheme . . . and to influence public opinion." In particular,

- A policy document, which presumably would be written after the scientific analysis was carried out and reviewed by other experts, was written before the analysis was completed.

- To provide scientific support for the EPA's predetermined conclusions, its scientists had to "cherry pick its data." The report contained a selective review of scientific literature that ignored both many relevant studies and criticisms of many that are cited. It also contained a statistical reanalysis of 11 U.S. studies, none of which provided support for the desired conclusions at standard levels of statistical confidence. By re-analyzing those studies together (using "meta-analysis") and abandoning the commonly accepted standard for statistical confidence (effectively doubling the chances of being wrong), the EPA was able to support the predetermined conclusion that evidence of a "substantial public health impact" exists.

Bruce Benson is DeVoe Moore Distinguished Research Professor at Florida State University in Tallahassee.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

- The validity of the re-analysis cannot be assessed because the EPA report does not provide sufficient information about the studies and process, leading the judge to conclude that "The court is faced with the ugly possibility that EPA adopted a methodology for each chapter, without explanation, based on the outcome sought in the chapter." Furthermore, if the two most recent U.S. studies that were then available (one funded by the National Cancer Institute and one by the World Health Organization) had been included in the re-analysis, the results apparently would not have been statistically significant even at the lower level of confidence.

I could go on, but the point is that the EPA, supposedly an agency whose policies are based on valid scientific evidence, is willing to manipulate that evidence in pursuit of a political agenda. Indeed, despite this judicial decision and numerous studies contradicting the EPA's position, Administrator Carol Browner described the court decision as "disturbing" because "it is widely accepted" that the dangers alleged in the report are "very real." Apparently, wide acceptance of an idea is justification enough for a policy, whether the scientific evidence supports it or not! The possibility that the EPA's misleading report may have influenced this "wide acceptance" does not seem to matter either.

Questioning Integrity

The EPA is appealing the ruling, so it is far from final. Some agency officials have even questioned the integrity of the judge because he is located in North Carolina, the nation's leading tobacco-producing state. But the same judge ruled, only a year earlier, that the Food and Drug Administration has the authority to regulate cigarettes, despite strong protests by the tobacco industry. The judge also was not the only person to be concerned about the report. Two internal EPA documents from its Environmental Criteria and Assessment Office argued, before the 1993 Report was issued, that it was badly conceived and presented, that it overstated the alleged causal relationship, and that the conclusions were unwarranted. More important, the court ruling apparently has just uncovered the tip of the iceberg. In 1992, EPA's own Science Advisory Board lamented that the agency pays inadequate attention to peer review and quality assurance, "leaving EPA initiatives on shaky scientific ground and affecting the credibility of the agency."

More and more EPA scientists are also alarmed at how policy is increasingly made at the expense of scientific integrity. In all likelihood, scientists who work for EPA are concerned about environmental issues and predisposed to supporting strong policies. But many also care about the credibility of their agency and their scientific disciplines.

For instance, David Lewis, a research microbiologist, risked his 27-year career at EPA by writing to Browner and Vice President Al Gore deploring the deterioration of science at the agency. When he got no response, he published an article titled "EPA Science: Casualty of Election Politics" in the highly respected journal *Nature*, arguing that the agency gives "a higher priority to issuing regulations than to developing the underlying science." Elsewhere he attacked the agency's wastewater toxicity tests as being unreliable. Subsequent studies performed outside the agency support his criticisms, and perhaps as a result, the agency no longer uses the tests. But Lewis was still charged by EPA officials with an array of ethics violations. He felt the need to file a whistleblower's complaint with the Labor Department, which concluded that EPA officials had violated six federal statutes in harassing him.

Spreading Skepticism

Despite Lewis's vindication, complaints by one employee might be dismissed, but he is not alone. The increasing complexity of the EPA's own internal rules, along with a commitment to punish anyone who does not follow those rules, has given EPA management considerable discretion, which can be employed to harass whistleblowers and others who express dissatisfaction with the agency's

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

activities or procedures. And such harassment is becoming common. On June 10, 1998, more than a dozen career employees of the agency sent a letter to the *Washington Times* "risking our careers rather than choosing to remain silent" about the "egregious misconduct" at EPA. The letter explains that the "retaliation against whistleblowers . . . at every management level" and other "illegal or irresponsible behavior by managers" in pursuit of political agendas "jeopardize the proper enforcement of law." In other words, while these employees believe that there is a proper role for the EPA in enforcing scientifically valid environmental restrictions, they see that role being jeopardized, just as Lewis did. Some lab scientists who do not follow the "party line" are apparently even being charged by the EPA's Inspector General's office for alleged corrupt practices, although federal administrative judges are throwing out such cases and accusing the IG of carrying out investigations in bad faith. (See Bonner R. Cohen, "Polluted Agency" *National Review*, August 1, 1998, pp. 38–39.)

No matter what position on secondhand smoke or water-quality measurement or any of a number of other policy issues one might support, scientists should be concerned about the politicization of their research. When shoddy practices such as those revealed by Lewis and the federal judge are passed off as science, people begin to doubt other "scientifically justified" policy recommendations and regulatory standards. Critics of policies ranging from ozone protection to the banning of dioxin and other alleged carcinogens have done just that.

Supporters of those policies of course attack the scientific arguments of their opponents, making the physical sciences look like the social sciences—capable of providing evidence to support any politically motivated proposal. Those of us who already dismiss claims made by politicians and social-scientist "experts" on retainer in political causes are developing the same attitude about claims by biologists, chemists, and other physical scientists, at least when their research is cited in the public policy arena. If scientists do not stand up against the political manipulation of their research, their credibility will soon be similar to that of politicians, lawyers, and alas, economists. □

Annual Trustee's Dinner • May 16, 1999

featuring

WALTER E. WILLIAMS

John M. Olin Distinguished Professor of Economics

Chairman of the Economics Department at
George Mason University
Columnist, *The Freeman*

For more information and reservations, please contact
Janette Brown at FEE: (800) 452-3518.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Flunking Economics

Why should we care about economic literacy? Are we troubled by illiteracy in physics? Or metaphysics? Should we worry that most of us can't remember much of the periodic chart of the elements? Why should we worry more about economics? Because economic illiteracy is dangerous. I can ride on a roller coaster without understanding centrifugal force. In fact, even if I refuse to believe in centrifugal force and actually create a new religion on that basis, I will probably stay in the roller coaster as I careen around the corner. Physics can protect me, whether I believe it or not. But if I ignore basic economics, I could go broke. And if a country ignores basic economics, it could go bankrupt.

That's the opening paragraph of an essay titled "Hope and Danger for Economic Literacy" by economist Todd G. Buchholz, one of several fine essays published in the December 1998 issue of *The Region*, a quarterly journal of the Federal Reserve Bank of Minneapolis. The issue was devoted to what Americans know, don't know, and should know about economics.

Buchholz is right. The level of economic knowledge will make or break an individual or a nation of individuals. When people understand the subject, its principles, and its implications, they can raise the standard of living and solve problems.

When people don't understand economics, they gullibly embrace "quick fix" promises that erode the standard of living and blindly support impractical "pie-in-the-sky" solutions that make problems multiply and worsen.

So economic education is important, and Americans today need heavy doses of it. Ordinarily, it might make sense to recommend that Americans pick up a high school economics text and read it from cover to cover. Sadly, that would be very poor advice.

My colleague Burton Folsom has directed a Mackinac Center for Public Policy review (written with George Leef and Dirk Mateer and released this month) of 16 of the top-selling high school economics textbooks. Folsom found only six texts he could grade either A or B for economic accuracy. Each of the rest rated a C, D, or F. If he hadn't been generous enough to grade on the curve, more than half might have flunked.

Errors abound in the texts students are using in high school economics classes, more than an entire issue of *The Freeman* could address. What follows is a small sample of the worst ones. These statements are so inexcusably erroneous that they have no business appearing in print on any page of an economics text worthy of the name.

"*As societies become more complex, the need for government power tends to increase.*" From Sanford Gordon and Alan Sanford's *Applying Economic Principles*, this little canard is tossed out in a matter-of-fact, everybody-knows-it fashion.

Lawrence W. Reed is president of the Mackinac Center for Public Policy (www.mackinac.org), a free-market research and educational organization in Midland, Michigan, and chairman of FEE's Board of Trustees.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Are these guys utterly unaware of F. A. Hayek's withering critique of central planning? (Hayek and most economists would surely dismiss the statement as a "pretense of knowledge" if there ever was one.) Have Gordon and Sanford never heard of public choice, the school of thought within economics that explains the inherent defects in government action? Do they not know that one of the many reasons for the collapse of the Soviet socialist empire was the utter incapacity of the state to keep up with the information and innovations of competitive markets?

FEE's Leonard Read demolished this simplistic notion decades ago by pointing out that the impossible task of one person's planning the life of another is made even more hopelessly complex when a handful of people in government set out to plan the lives of millions. "Obviously, the more complex our economy, the more we should rely on the miraculous, self-adapting processes of men acting freely," wrote Read.

"Despite fears by some Americans that governmental tampering with the free enterprise system would be harmful, most government policies have met with success." David E. O'Connor, with a straight face, asks us to believe this statement in his text, *Economics—Free Enterprise in Action.*

Government doesn't always fail, to be sure—especially if you're not picky about what "failure" means. But the track record hardly suggests that "most" of its policies have been successful. Education? Studies show the more government spends and meddles, the worse the schools get. Money? At least seven or eight recessions, a Great Depression, and a currency worth a nickel of its value when the Federal Reserve System was established does not add up to success. Poverty? We now know beyond dispute that $5 trillion in poverty spending only exacerbated the problem. On and on it goes, but you get the picture.

"During the Industrial Revolution, 'wages were so low that sometimes entire families had to work.'" Richard Hodgetts and Terry Smart employ this assertion in their text, *Economics*, to imply to the reader that the Industrial Revolution set society back because it made many people work for the first time.

If text authors could be sued for malpractice, Hodgetts and Smart would need skillful attorneys to handle this one. Evidence by the boatload shows that life was far more "nasty, brutish, and short" in the days before industrialization boosted productivity and gave people a chance. Kids did not dance their time away around the maypole in 1400; large numbers of them died before the age of five and those that survived typically labored under appalling conditions and never heard the phrase "summer vacation."

"Under a balanced budget, the government would 'not be able to do things that many people think it should do, like building roads and providing for the needy.'" Henry F. Billings, in his *Introduction to Economics*, apparently believes either a) when government runs a deficit so that it can spend more than it raises in taxes, we get the extra goodies for free, or b) people have to be bamboozled into programs they wouldn't want to pay for.

After 30 years of nonstop deficit spending, no intelligent adult has a legitimate excuse for thinking that red ink makes anything cheaper or more readily available. A balanced budget means taxpayers pay now for what they get from government. Deficit spending simply means that today's taxpayers get the goodies and tomorrow's get the bills, plus a hefty interest charge.

How does this junk—and so much more, as documented in Folsom's study—find its way into high school economics texts? One reason is that high school teachers drive the market, and few of them who are asked to teach economics have either majored in the subject at college or have demonstrated any particular competence in the field. Publishers even assemble focus groups of such teachers; if they say, "We like the minimum wage!" then that's what the authors of texts are told to include in the books.

Another reason is the general level of economic ignorance throughout our society. It's an enduring, pandemic affliction that underscores the need for the work of organizations like FEE. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Wasting Energy on Energy Efficiency

by Ben Lieberman

Few aspects of our daily lives are more heavily regulated by the federal government than our use of energy. The cars and trucks we drive, the structures in which we live and work, and virtually every major appliance we use has been transformed by Washington's near obsession with energy efficiency. Chances are, if it runs on electricity, gasoline, natural gas, heating oil, or any other energy source, it has been substantially affected by federal laws and regulations.

The energy efficiency crusade was originally launched in the 1970s as part of the solution to the so-called energy crisis. Washington was convinced that world oil supplies were rapidly dwindling and that drastic energy conservation measures were needed. As a result, Congress enacted several laws for the purpose of reducing energy consumption. Some statutes set energy-use standards, be it miles per gallon for motor vehicles or kilowatt hours per year for refrigerators. These laws not only set initial standards but gave the implementing agencies (Department of Energy [DOE] for most appliances, National Highway Traffic Safety Administration [NHTSA] for motor vehicles) the authority to periodically tighten them without going back to Congress for approval. Several laws also created tax incentives or other inducements for individuals and businesses to reduce energy use beyond the level they would achieve on their own.

Ben Lieberman is a policy analyst with the Competitive Enterprise Institute in Washington, D.C.

A Second Ill Wind

The energy crisis has long since faded away. The "experts" could not have been more wrong—oil supplies are so plentiful today that the price has reached a 25-year low. Nonetheless, the efficiency agenda lives on. These same statutes and regulations, and the army of bureaucrats and activists that make their living from them, are experiencing their second wind as one of the putative solutions to global warming. If consumers can be made to use less energy, the argument goes, then less carbon dioxide, the chief anthropogenic greenhouse gas, will be emitted into the atmosphere.

Last November, when the Clinton administration signed the Kyoto Protocol, the international agreement to reduce emissions of greenhouse gases, Stuart Eizenstat, undersecretary of state for economic, business, and agricultural affairs, emphasized the role energy efficiency will play in its implementation. He announced new funding for research into more efficient automobiles and housing, and an effort to "begin setting new energy efficiency standards for major appliances." Indeed, until the Kyoto Protocol is submitted to a skeptical Senate for approval, these already existing energy-efficiency statutes are among the few tools the Clinton administration can legally use to combat energy use.

Before the nation embarks on new rounds of tougher efficiency standards for everything from washing machines to light bulbs to SUVs, it is worth examining what the first

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

wave of such centrally planned austerity measures has done for us. Despite the positive publicity accorded measures enacted in the name of energy efficiency, they have accomplished nothing. However, they have raised the cost and reduced the quality of affected products, and have created or exacerbated several health and safety problems.

An Ineffective Solution

Even assuming the global warming crisis is not as spurious as the energy crisis (but see Jonathan Adler, "Global Warming: Hot Problem or Hot Air?" in *The Freeman,* April 1998) and that substantial environmental benefits will accrue from reduced energy use, there still are serious limitations on how much can be achieved through federally mandated energy efficiency measures. True, if consumers use less energy, then less carbon dioxide will be emitted into the atmosphere, either directly in the case of motor vehicles or fuel-burning appliances, or indirectly in the case of electrical appliances whose energy is generated through fossil-fuel combustion by utilities. But 25 years of energy efficiency measures have failed to stem the increases in national energy use.

"People always seem to find more uses for energy," says Herbert Inhaber, author of *Why Energy Conservation Fails*. Today's refrigerators may require half the electricity of a comparable 1980 model, but people are more likely, given the lower operating costs, to own a larger one, or even have two. Better gas mileage has led to increases in vehicle miles traveled. Studies have shown that owners of high efficiency heating systems tend to set their thermostats a bit higher than others. Many consumers "spend" their savings from efficient appliances on other energy-using conveniences, like additional lighting. Ironic but true, a quarter century of federal energy-efficiency mandates has increased, not decreased, total energy use.

Ratcheting down current efficiency standards will probably have the same effect. In all likelihood, the only way for Washington to actually reduce energy use is to sharply increase energy costs. Proponents of the Kyoto Protocol are also seriously considering energy taxes or other price-raising schemes, but these cannot be enacted until the treaty is ratified, or new legislation is enacted. In addition, such options are fraught with the kind of direct adverse political consequences the energy efficiency agenda has thus far avoided.

Bad Deal for Consumers

The level of consumer satisfaction with many things targeted by the energy-efficiency crusade has declined as a result of Washington's dictates. This should not be surprising—in a free market, most technological improvements that allow efficiency gains without adverse side effects would be incorporated anyway. Manufacturers, responding to competitive forces, have plenty of incentives to provide the best available balance of price, performance, and operating costs. Efficiency mandates simply upset this balance, placing arbitrary energy-use standards above everything else. Alan Kessler, vice president of Raytheon Appliances, noted in congressional hearings on appliance standards that "from the perspective of DOE and standards advocates, the purpose of major appliances is solely to save energy," and not to provide maximum overall consumer satisfaction.

Energy efficiency, Washington-style, comes at a cost. For example, DOE estimates that the latest energy standard for refrigerators will add $80 to the cost of a new model when the standard takes effect in 2001. DOE is also considering regulations mandating certain highly efficient types of clothes washers that currently cost hundreds more than their conventional counterparts. One study estimates the total cost of appliance standards of $59 billion. True, these and other goods save on energy, but the payback periods are often very long.

Beyond appliances, studies have also shown that the sticker price of automobiles has increased because of NHTSA's Corporate Average Fuel Economy (CAFE) standards, and that energy-saving features add considerably to new housing costs.

Quality also suffers. Air conditioners rated as highly efficient under the federal standards

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

are less reliable than average models and some do a poor job dehumidifying the air. "I've seen state of the art, high efficiency air-conditioners in homes where there's mold and mildew on the walls," says Dave Debien, owner of Central City Air, in Houston. Many consumers are dissatisfied with the weak trickle from federally mandated low-flow shower heads. Some highly efficient refrigerators have freezer sections that don't stay as cold as they should to safely preserve foods for extended periods. Efficiency mandates often have a performance downside to go along with the energy savings.

Beyond the effect on price and quality, these standards also limit the choices available to consumers. Kessler noted that the need to meet arbitrary efficiency standards is leading to product lines "so homogenized and energy-oriented that other product innovations or features are placed on the shelf." In addition, several manufacturers have stopped producing certain products, such as the lowest priced air conditioners, because they have been rendered unprofitable by efficiency regulations. Directly and indirectly, Washington is telling us what we can and cannot have.

The efficiency crusade has also exacted a price in health and safety. The problem of indoor air pollution is in large part attributable to the government's attempts to conserve on energy used to heat and cool homes and buildings. Though the federal government does not directly set energy standards for homes and offices, it has been quite effective in doing so indirectly. For example, Washington requires that newly constructed houses meet certain efficiency requirements in order to be included in federally backed mortgage programs. The government also pays for insulation in low-income housing, and has provided tax breaks for energy-saving expenditures.

These and other efforts sought to reduce "excessive" ventilation, considered wasteful of energy. Granted, heavily insulated, weather-tight buildings and homes do save energy by holding in more of the already heated or cooled air and reducing the influx of outside air. However, there has been an unanticipated side effect—these energy-efficient structures concentrate the levels of contaminants inside. The result has been a two-decades long increase in indoor air-related health problems as people inhale higher levels of airborne pollutants, including biological contaminants from molds, mildew, microorganisms, and insects, as well as chemicals like formaldehyde and volatile organic compounds. Even the federal government has admitted this oversight. The Environmental Protection Agency (EPA) now concedes that "the current trend toward sealing off homes to conserve energy may have serious health consequences."

Perhaps most disturbing is the sharp rise during this period in the incidence and mortality of pediatric asthma, especially among minority youth. While the reasons for this increase are not fully understood, one *New England Journal of Medicine* editorial suggested "decreased ventilation after the energy crisis in the United States in the 1970s" as one possible cause of increased exposure to the indoor contaminants that trigger and exacerbate asthma attacks.

Deadly Light Cars

CAFE standards may have also cost thousands of lives. To meet the average-miles-per-gallon requirements, automakers have had to reduce the weight of cars. Studies have consistently shown that, all other things equal, lighter vehicles are less crashworthy. A 1989 Harvard/Brookings study estimated that CAFE standards have increased motor vehicle fatalities by 14 to 27 percent. This works out to about 2,000 to 4,000 lives per year. As is typically the case with the energy-efficiency agenda, such non-efficiency considerations have been almost completely ignored by the government. CAFE proponents now want to sharply raise the bar on automakers to help avert the highly speculative threat of global warming, but still deny the well-documented size-safety tradeoff.

The frequency with which federal measures to promote energy efficiency have led to these adverse "unintended consequences" has an interesting flip side. In retrospect, the levels of energy use in appliances, houses, and vehicles prior to Washington's interference implicitly included a good deal more wisdom than their

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

critics assumed, for they managed to avoid these problems. Once again, so-called market failures turn out not to be such failures after all. It's the efficiency mandates that have proven more regrettable.

The Future of Energy Efficiency

Federally mandated energy efficiency has been touted as a real win/win policy for consumers—we save on energy and enjoy the societal benefits from a national decline in energy use. In reality, it has been lose/lose—we must endure the negative effects of Washington's preoccupation with energy conservation while the overall policy proves pointless.

The real winners are the hundreds of energy-efficiency bureaucrats and allied activists, most of whom receive substantial federal funding for their efforts. They are frequently joined by opportunistic manufacturers who stand to benefit from federal energy policy, such as insulation producers or appliance makers who believe that their most efficient models are superior to the competition and can gain market share if a new standard is promulgated.

Thus far, these special interests have made for an almost unbeatable coalition. The energy-efficiency activists occupy the moral high ground, at least among Democratic legislators and the media, and the industry proponents provide enough lobbying clout and Republican support to win the day. The Naderites and other big consumer advocates are so smitten with the efficiency agenda that they turn a blind eye to its adverse effects on consumers; thus the battles have been mostly one-sided.

But there are a few signs that the efficiency crusade has marched too far. The 104th Congress set a moratorium on new energy efficiency standards for appliances, though it was criticized for doing so and eventually lifted it. Nonetheless, the moratorium managed to kill some truly silly regulations, like the proposed prohibition on oven windows, and delayed the implementation of several others.

Low-flow showers and toilets have been so unpopular that they sparked a grassroots backlash. In response to constituent complaints, Representative Joseph Knollenberg introduced a 1997 bill to repeal the low-flow requirements. The bill garnered 76 co-sponsors, not bad for a supposedly anti-environmental and anti-conservation measure. Knollenberg has promised to introduce a new bill in 1999.

The burgeoning backlash will only intensify if Washington embarks on new rounds of standards in the name of fighting global warming. The efficiency gains that were relatively easy to achieve have long since been used up to meet existing standards, and even those have proven quite painful. Whatever the alleged merit, additional federal micromanagement may impose an unacceptably severe impact on cost, quality, health, and safety.

Nonetheless, the Clinton administration is intent on spending more of our tax dollars to come up with new restrictions on our choices in the marketplace. Such measures will be an expensive nonsolution to an unproven problem.

Washington should stop wasting its energy. □

The apple icon identifies *Freeman* articles that are appropriate for teaching high-school students several major subjects—including economics, history, government, philosophy, and current issues.

We also provide sample lesson plans for these articles on our Web site **www.fee.org** and in written form. Teachers and homeschooling parents need only to visit our Web site or request written lesson plans to take advantage of this unique service.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Paper Tiger

by Christopher Mayer

Gadflies have long been predicting the exhaustion of critical natural resources —especially oil. Despite the doomsaying, a barrel of oil is cheaper today than a pair of movie tickets.

As Daniel Yergin pointed out in a recent editorial in the *Wall Street Journal*, "prices, in inflation-adjusted terms, are at a level that has not been seen since 1973, prior to the oil embargo and the first oil crisis." In addition, the cost of exploring and developing crude is now only about $5 per barrel compared with over $21 per barrel in 1982.

Any cursory review of the history of real oil prices will show a long downward trend. It would seem oil is getting less scarce. And it would seem that there is no reason for this trend not to continue. This line of reasoning is vigorously pursued in the late Julian Simon's book *The Ultimate Resource 2*.

With oil prices at record lows, it is perhaps appropriate to reflect on the triumphs of markets and the erosion of the power of OPEC, the Organization of the Petroleum Exporting Countries. OPEC is often thought of as an Arab organization, but four of the 11 members—Iran, Nigeria, Venezuela, and Indonesia—are not Arabic. (See www.opec.org.) That's not the only misconception about OPEC.

Low oil prices persist despite OPEC's best efforts to support a higher price. In fact, market forces have made OPEC a paper tiger. Alan Abelson of *Barron's* astutely noted that years ago "In contriving to push up the price so precipitously, it inspired a frantic hunt for new deposits of oil and gas and, at the same time, set off formidable efforts at conservation. Which, of course, is the way markets inevitably work."

Services, Not Substances

Oil is used more efficiently today, and new sources are constantly being found. Importantly, substitutes for oil are also being developed and used. Remember, it is not oil itself that concerns us. Rather, it is the services that oil provides that are important. We should not care if, in a highly unlikely and theoretical scenario, we ran out of oil, as long as the service that oil yields is provided just as adequately by some substitute.

The world's experience with the energy crisis is consistent with deductive theory regarding the essential role of market prices in mobilizing economic forces to best provide for consumers' most urgent wants. As Simon wrote in *The Ultimate Resource 2*: "Heightened scarcity causes prices to rise. The higher prices present opportunity, and prompt investors and entrepreneurs to search for solutions. Many fail, at cost to themselves. But in a free society, solutions are eventually found. And in the long run the new developments leave us better off than if the problems had not arisen."

Christopher Mayer, a commercial loan officer, is studying for an MBA at the University of Maryland. Contact him at cwmayer@aol.com.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

We are better off because the market process yields more goods that cost less. Of course, for this type of activity to occur, people must have the freedom to employ their capital as they wish. The market process must be allowed to work free of government meddling. This goes against the conventional wisdom that when energy prices rise, government should induce conservation. (See the preceding article by Ben Lieberman.)

OPEC as Cartel

Can't OPEC wield cartel power? Economic theorists have long recognized the unstable nature of cartels. A cartel is an organization of separately owned producers cooperating, often through quotas on production, to achieve a price above what the free market would have chosen. On a free market, these arrangements fail because of the market forces they set into motion.

Simon pointed out that "A cartel such as OPEC, whose members have differing interests, is subject to pressures that make it difficult to maintain whichever price maximizes profit for the cartel as a whole. There is a great temptation for individual countries to sell more than their quotas."

The problems inherent in any cartel can best be illustrated by the prisoner's dilemma. Sharon Oster, in her book *Modern Competitive Analysis*, writes that in the prisoner's dilemma, "the payoffs are such that both players have individual incentives to choose strategies that together give both players a worse outcome than if both players had simultaneously chosen the other strategy."

To illustrate, say two prisoners are separated and told that if one confesses to a joint crime, both will be convicted, but the confessor will get a light sentence, say, one year, while the other prisoner will get ten. If neither confesses, they each will get two years. Individually, their incentives are to confess to serve the shortest time imprisoned. Jointly, it would be best if both kept quiet. This was a good approximation of the situation faced by OPEC, when it had a better grip on the world's supply of oil.

Some critics point to the fact that OPEC is still the low-cost producer and if oil prices continued to fall, OPEC would regain market share and its monopoly power.[1] I would first point out that the more oil prices fall the greater boon for oil consumers. Also, the fact that oil prices could fall further is a reflection of increased supply or slackening demand on the free market (ignoring money-induced changes or government price-fixing), neither of which would be cause for concern if we believe that market prices transmit valuable information regarding efficient resource allocation. We shouldn't care who produces the oil, only that we can purchase it when we need it. I am reminded of Bastiat, who made the point this way:

> Suppose someone tells you: "It is essential for a great country to have an iron industry." Answer: "What is more essential is that this great country *have iron*."[2]

OPEC wouldn't be helped by expanding to include American producers. There will always be an incentive for the better producers to cheat on the cartel.

The abundance of oil today is a testament to the ability of prices to send signals to entrepreneurs about consumers' most urgent wants. It is an illustration of the market's ability to organize and deliver goods efficiently. And finally, it shows that in a free market, there is no such thing as monopoly power, for it will not be long before the monopoly that attempts to defy the market is broken. As Horace said, "Many shall be restored that are now fallen and many shall fall that now are in honor." □

1. Ron Chernow, "No Funeral for OPEC Just Yet," (*New York Times*, January 5, 1999). Chernow makes the point that the cost of extraction is only $2 per barrel for OPEC, versus $7 per barrel for "super-efficient" Exxon on domestic oil and more than $10 per barrel on foreign oil.

2. Frederic Bastiat, *Economic Sophisms*, from the essay titled "The Little Arsenal of the Freetrader" (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1964), p. 251.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

China's Spontaneous Order

by James A. Dorn

This year marks the 50th anniversary of the People's Republic of China and the tenth anniversary of Tiananmen Square. The spontaneous demonstrations for freedom that took place in the heart of Beijing in May and June a decade ago met with a dramatic and tragic end when confronted with the power of the state.

It is no coincidence that the monopoly of power exercised by the Communist Party and the horrid events of 1989 are related. The party can survive only by its ultimate reliance on the use of force to prevent competition from those who would contest single-party rule. The recent crackdown on the founders of the first opposition party in the history of the PRC, the Chinese Democratic Party, attests to the insecurity of the ruling elite.

Yet, even in the face of an oppressive government, the Chinese people have made substantial economic progress since 1978. They have done so because brave individuals have been willing to challenge the planned economy and because the communist party under the leadership of Deng Xiaoping recognized the failure of planning and the value of a market system. But the party has been unwilling to abandon its vision of a "socialist market economy" and allow a true market system to evolve.

The party leaders believe that without their firm guidance, life in China would be chaotic and unstable, and the economy would grind to a halt. No one better represents that view than Jiang Zemin, China's president and chairman of the Communist Party. This past December, he celebrated the 20th anniversary of China's economic reform, and attributed its success to "unswerving adherence to the Party's basic line." By his logic, continued economic success depends on the survival of the Communist Party and on the primacy of public ownership.[1] Nothing could be further from the truth.

The Secret of China's Success

China's economy has grown by nearly 10 percent a year since 1978 because the government has gotten out of the way of the market and allowed individuals greater economic freedom—not because of strict adherence to the basic party line, which holds that the individual is a cog in the socialist state. The truth is that China's economic reforms have succeeded because some individuals were willing to risk everything to escape the iron grip of state planners and a life with no future.

The first steps were taken by farmers who resisted state coercion under the communal system and initiated what Kate Xiao Zhou, author of *How the Farmers Changed China*, calls "a spontaneous, unorganized, leaderless,

James Dorn (jdorn@cato.org) is vice president for academic affairs at the Cato Institute and professor of economics at Towson University. He is the editor of China in the New Millennium: Market Reforms and Social Development *(Cato Institute, 1998). A shorter version of this article appeared in the* Journal of Commerce.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

nonideological, apolitical movement."[2] The goal was to create a market-oriented system under which farmers would have greater control over the land at their disposal and be able to profit from voluntary exchange. It was only *after* that limited, spontaneous experiment with the "household responsibility system" (*baochan daohu*) proved successful that the party sanctioned the new arrangement.[3]

As farmers gained wealth, they expanded into nonfarm production and experimented with a new form of collective ownership—the so-called township and village enterprise (TVE). Rather than actively promoting that new ownership form, party leaders cautiously observed its operation. Once success was evident, the Communist Party again was willing to permit expansion. However, it never envisioned that TVEs would far outperform state-owned enterprises. According to Deng, "Our greatest success—and it is one we had by no means anticipated—has been the emergence of a large number of enterprises run by villages and townships. They were like a new force that just came into being spontaneously."[4]

Today, the market-driven, nonstate sector, which includes TVEs, foreign-funded enterprises, private enterprises, and other firms that are not dependent on government handouts, is the dominant force in China's "socialist market economy." More than 70 percent of industrial output value is now produced outside the state sector. Most state-owned enterprises, on the other hand, are losing money and eating up China's capital—more than 50 percent of state investment funds go to these collectives.[5]

Another example of spontaneous order in China is the special economic zones. Those zones were first set up in the coastal areas, but the idea spread to other areas and took on new forms as competitive forces led some local officials to permit the growth of markets and foreign investment *before* receiving approval from the central government. Once the new institutions were successful, however, official recognition followed.[6]

China's economic success has been the result of millions of hard-working Chinese being set free to pursue a better life. The relaxation of price controls has allowed the market, rather than the plan and the party, to guide production and consumption. The continuing depoliticization of economic life has given people more time and energy to devote to everyday affairs. Personal freedom has inched forward as a consequence. People are now free to work outside the state sector and to choose their life's work, to buy from alternative sources, to invest their money, and to enjoy the infusion of new products and new ideas brought about by trade liberalization.

The real lesson from China's "economic miracle" is not that economic development depends on adherence to the "party's basic line," but that economic freedom is essential for increasing human well-being.

A Constitution of Liberty for China

The willingness of China's leaders to open the country to the outside world, to permit new ownership forms, and to abolish much of the state planning system in favor of market pricing should be congratulated. But the lack of commitment to private property rights and, therefore, to limited government and the rule of law means that China's future is unclear. So long as the market is contaminated by party politics and state planning, corruption will continue to pollute China's economic environment.

If China wishes to continue its rapid economic growth into the next century and end corruption, it must strive for institutions that are consistent with free-market principles and the rule of law. That is why Justin Yifu Lin, Fang Cai, and Zhou Li argue that "It is essential for the continuous growth of the Chinese economy to establish a transparent legal system that protects property rights so as to encourage innovations, technological progress, and domestic as well as foreign investment in China."[7]

Ultimately, economic and political reform are inseparable. To depoliticize economic life and nourish China's fragile spontaneous market order, there must be constitutional change and new thinking (*xin si wei*). The Chinese people need to understand and appreciate the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

nature of spontaneous order and the institutions that underlie that order—namely, private property, freedom of contract, and limited government. Most of all they need to adopt what F.A. Hayek called a "constitution of liberty."[8] As Roger Pilon, director of Cato's Center for Constitutional Studies, stated, "If China is to preserve and expand upon its recent achievements, it will need a constitution that institutionalizes, not simply tolerates, the forces that have led to improvements there."[9]

Chinese scholars are beginning to realize the necessity of constitutional change. In 1991, Jixuan Hu argued that the market is a "living system" that cannot be designed. "By setting up a minimum group of constraints and letting human creativity work freely, we can create a better society without having to design it in detail. That is not a new idea, it is the idea of law, the idea of a constitution."[10] To accept that idea, however, means to understand and accept the notion of spontaneous order and the principle of nonintervention (*wu wei*) as the basis for economic, social, and political life.

But as Pilon explains, the development of China's spontaneous market order is being limited by the Communist Party's adherence to a constitution that turns the relation between the individual and the state on its head. Instead of protecting individuals and their property rights, the Chinese constitution makes the individual subservient to the state and narrowly circumscribes rights, allowing only that amount of freedom that does not threaten party rule. Rights are temporary and arbitrary, not permanent, and depend solely on the will of the rulers.[11]

What China needs is a government of limited powers that respects the life, liberty, and property of each individual—not 100 more years of communist rule and "public" ownership. It is not enough that China has permitted the market to develop; China must now recognize the futility of trying to plan the market and to control the lives of 1.3 billion people. A better way is to increase freedom within a constitutional setting that establishes general rules to constrain government and let people be free to choose.

Lao Tzu Thought

In considering what steps to take next, China's leaders should look to their own ancient culture and rediscover the principle of spontaneous order—the central principle of a true market system.[12] In the *Tao Te Ching* (also known as the *Lao Tzu*), written more than 2,000 years before *The Wealth of Nations*, Lao Tzu instructed the sage (ruler) to adopt the principle of noninterference as the best way to achieve happiness and prosperity:

> Administer the empire by engaging in no activity.
> The more taboos and prohibitions there are in the world,
> The poorer the people will be.
> The more laws and orders are made prominent,
> The more thieves and robbers there will be.
> Therefore, the sage says:
> I take no action and the people of themselves are transformed.
> I engage in no activity and the people of themselves become prosperous.[13]

"Lao Tzu Thought," not "Mao Zedong Thought," is the beacon for China's future as a free and prosperous nation.[14]

Truth versus Party Line

The truth is, the basic party line is inconsistent with a spontaneous market order and a free society. When push comes to shove, the party, not the individual, rules, and no dissent is tolerated. Until that totalitarian mentality is contested, China's future will be plagued by uncertainty, and the nascent market economy will be in constant danger.

The right to dissent—that is, to be different, to think, to choose—is the hallmark of a free and civil society. The party's recent crackdown on dissidents, including the harsh sentencing of Zhang Shanguang to 10 years in prison for "informing" Radio Free Asia of the protest by 80 farmers in Hunan's Xupu County against excessive taxes, is yet one more egregious example of how the party's quest for "stability" is, in reality, a ploy to protect its monopoly power.[15]

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

It is time for the Communist Party to abandon its top-down model of "stability" and allow the forces of freedom and individual responsibility to create a new constitutional order from the bottom up—based on the consent of the people and a respect for their natural rights to life, liberty, and property. Only then will the institutional incompatibility that now exists in China's socialist market economy disappear and a true market-liberal order emerge—based on liberty and justice for all.

The recent publication and popularity of a Chinese language edition of Hayek's classic book *The Constitution of Liberty,* now in its second printing, is a sign that the old top-down order of planning and control is slowly giving way to a new spontaneous market order of liberty and opportunity. People are beginning to recognize the need for adhering to universal principles of justice. Mao Yushi, director of the Unirule Institute in Beijing, told the *Wall Street Journal*, "We need to make everyone equal before the law and set the rules of conflict resolution." In his opinion, liberty, not democracy, should be the primary concern.[16]

The challenge for China is to allow liberty to grow by adopting constitutional constraints on government power. In the end, it must be the Chinese people themselves who will have to meet that challenge by ending the power of the party and securing the power of the people to choose their own institutions. That will not lead to chaos but to a new spontaneous order for China. □

1. "President Jiang Says China to Maintain Socialist Economy" and "President Jiang Calls for Another 100 Years of Communist Rule," Agence France Presse, in *Inside China Today*, December 18, 1998 (http://www.insidechina.com/china/business/news/98121801.html and http://www.insidechina.com/china/news/98121808.html).

2. Kate Xiao Zhou, *How the Farmers Changed China* (Boulder, Colo.: Westview Press, 1996), p. 4.

3. See Justin Yifu Lin, Fang Cai, and Zhou Li, *The China Miracle* (Hong Kong: The Chinese University Press for The Hong Kong Centre for Economic Research, 1996), pp. 132–33.

4. Deng Xiaoping, *Fundamental Issues in Present-Day China*, translated by the Bureau for the Compilation and Translation of Works of Marx, Engels, Lenin, and Stalin under the Central Committee of the Communist Party of China (Beijing: Foreign Languages Press, 1987), p. 189.

5. East Asia Analytical Unit (EAAU), *China Embraces the Market* (Barton, Australia: EAAU, Department of Foreign Affairs and Trade, 1997), pp. 10, 338. Hugo Restall estimates that "as many as 70 percent [of state-owned enterprises] are losing money" ("China's Long March to Reform," *Wall Street Journal*, September 23, 1997, p. A22).

6. See Steven Lewis, "Marketization and Government Credibility in Shanghai: Federalist and Local Corporatist Explanations," in David L. Weimer, ed., *The Political Economy of Property Rights: Institutional Change and Credibility in the Reform of Centrally Planned Economies* (New York: Cambridge University Press, 1997), pp. 259–87. According to Lewis (p. 283), "By the early 1990s, when surplus domestic capital could be moved between localities and banks more freely, and as central and local authorities began to decrease their monitoring of rural localities, thousands of non-sanctioned land development companies and 'development zones' had sprouted up around China."

7. Justin Yifu Lin, Fang Cai, and Zhou Li, "The Lessons of China's Transition to a Market Economy," *Cato Journal*, Fall 1996, p. 226.

8. F.A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960).

9. Roger Pilon, "A Constitution of Liberty for China," in James A. Dorn, ed., *China in the New Millennium: Market Reforms and Social Development* (Washington, D.C.: Cato Institute, 1998), p. 333.

10. Jixuan Hu, "The Nondesignability of Living Systems: A Lesson from the Failed Experiments in Socialist Countries," *Cato Journal*, Spring/Summer 1991, p. 44.

11. Pilon, pp. 334–41.

12. Nobel laureate economist James M. Buchanan has called "the principle of spontaneous order" the "most important central principle in economics." (In J. M. Buchanan, *What Should Economists Do?* [Indianapolis: Liberty Press, 1979], pp. 81–82.) It is the idea that individuals seeking their own gain in a system of private ownership and free markets bring about mutually beneficial exchanges, and that competitively determined prices coordinate economic decisions without central planning.

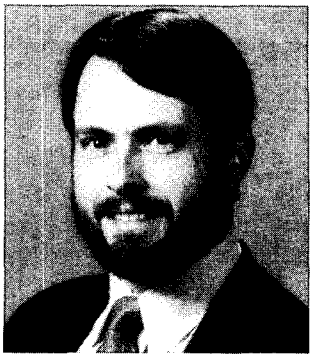
13. *Tao Te Ching* (the *Lao Tzu*), 57, in W.-T. Chan, *A Source Book in Chinese Philosophy* (Princeton, N.J.: Princeton University Press, 1963), pp. 166–67.

14. See James A. Dorn, "China's Future: Market Socialism or Market Taoism?" *Cato Journal*, Spring/Summer 1998.

15. See John Pomfret, "4th China Dissident Sent to Jail," *Washington Post*, December 28, 1998, p. A17.

16. "China Rediscovers Hayek," interview with Mao Yushi, *Wall Street Journal*, June 12, 1998.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Think Tank Wars and the Minimum Wage

True to form, Senator Edward Kennedy is pushing legislation to hike the minimum wage 41 percent, to $7.25 per hour by September 2002. President Bill Clinton has naturally jumped on the bandwagon, though he only wants to go to $6.15 an hour. He declared before last November's election: "We are fighting hard for the dignity of living wage [sic] in the face of partisanship that refused us last time."

But thanks to groups like the Employment Policies Institute (EPI), which regularly exposes junk research, the mirage that Uncle Sam can set wages without destroying jobs is starting to dissipate. Even some people who backed the raise three years ago are starting to have second thoughts.

Few economists doubt that artificially hiking wages lowers employment, since companies generally don't hire employees who can't earn their salaries. Scores of studies over the years have demonstrated the harmful employment effects of the minimum wage, though the magnitude of the job loss remains in dispute. Even former Labor Secretary Robert Reich acknowledged in a 1993 memo to President Clinton that "the potential effects of a minimum wage increase on employment should of course be weighed."

Four years ago Alan Krueger of Princeton and David Card of the University of California at Berkeley wrote a study arguing that a hike in New Jersey's minimum had actually increased employment. (Krueger and Card later reaffirmed their earlier conclusion, based on just three months of data after the 1996 federal wage hike took effect.) The counterintuitive study suffered from severe data problems, pointed out by EPI. Economist Finis Welch called the numbers "incredible." However, Senator Kennedy suddenly discovered the value of economic research and brandished the study at every opportunity. In 1996, an election-minded Congress raised the minimum.

In fact, it appears that the Pollyannas were wrong and the two-stage increase to $5.15 did cut employment. Overall employment has obviously increased in what remains a strong economy. But that jump came in spite of the rising minimum. The place where job losses typically occur is among the unskilled and ill educated, particularly blacks, teens, and female family heads. Alan Reynolds of the Hudson Institute found that six months after the 1996 installment took effect, unemployment rates rose in all three categories.

Moreover, EPI figures that the 1996 installment alone probably reduced the total number of jobs by about 380,000. The impact was particularly hard on teens, who found an estimated 128,000 fewer job openings. While overall employment rose, the rate for teens, especially black teens, fell. Today teen unemployment stands at about 17 percent, nearly four times the overall rate. Black teens have an unemployment rate of nearly 40 percent.

Doug Bandow, a nationally syndicated columnist, is a senior fellow at the Cato Institute and the author and editor of several books, including Tripwire: Korea and U.S. Foreign Policy in a Changed World.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Minimum-wage supporters reply with their own numbers, usually based on data choices that obscure employment changes. But even the most avid advocates of an increase flee from the logic of their position: if the minimum wage does not cut jobs, why not increase it by $100 an hour instead of just $2, as proposed by Kennedy, and make everyone rich? The reason, of course, is that he knows, and knows everyone else knows, that doing so would reduce jobs. Hiking the wage by less would eliminate jobs too, just not so many. A Heritage Foundation study figures that a $1 hourly increase would destroy 345,000 jobs in 2000. Overall employment would still rise, but not as much.

In fact, even Krueger now suggests caution. He explains that "David and I have said all along that there was a tipping point where a great enough increase in the minimum wage would start to reduce employment." He didn't think the economy was at that point in 1996. However, today he says, "I suspect now that another increase, coming quickly after the last one, would bring us closer to the tipping point and may even cross it." This defection has chastened Senator Kennedy—at least a little bit. "I am not ready to grant the job loss argument. But it is an argument that needs serious evaluation."

Such serious evaluation won't come from the Economic Policy Institute (EPoI), the labor-backed think tank that has long pushed for a higher minimum. EPoI's Jared Bernstein argues that raising the minimum would help "insure that low-wage workers get a fairer share of the economic growth."

How that would happen if they lose their jobs is unclear. So EPoI simply argues that wages have no impact on the employer's decision to hire. It is as if business were a charitable enterprise, hiring irrespective of productivity.

EPoI's research suffers from even more serious legerdemain than the Card-Krueger studies. In a 1997 report co-written by Bernstein, EPoI claimed that employment didn't fall after the 1996 hike. But it based that conclusion on just six months of data; researchers for the Employment Policies Institute found that adding just three more months of data reversed that conclusion. EPoI also contended that most of the gains from the 1996 minimum wage increase went to "the poorest 40 percent" of low-income working families. That sounds good, except for the fact that EPoI defined a "family" as just about anything, including a single person. And one could fall into the category of "poorest" American by earning up to $37,000. In fact, even using EPoI's curious methodology, two-thirds of the gain went to families with incomes above $25,000.

Baltimore's Preamble Center for Public Policy study, which cites the Card/Krueger and EPoI research (and which is also cited by Kennedy), is even more dubious. It allegedly analyzed a city ordinance (one of the nation's first "living wage" measures) that set a minimum wage of $6.10 (later increased to $6.60) for municipal contractors. Preamble declared that, magically, city costs fell by $500,000. Preamble relied on contracts that had been re-bid and others that were exempt from the ordinance. Had these effects been included, average costs would have risen.

There is an odd connection between these examples of bad research. Robert Reich was a member of EPoI's board before becoming secretary of labor in the first Clinton cabinet. He later hired Alan Krueger as his chief economist. EPoI's study was partially funded by the Department of Labor. EPoI and Preamble share the same research director, Mark Weisbrot, who happened to write Preamble's living-wage study. Organized labor helps fund EpoI, political supporters of the minimum wage, and living wage electoral campaigns. Indeed, it looks an awful lot like, well, a vast left-wing conspiracy.

Advocates of the minimum wage have not been able to repeal the law of supply and demand. If you make something more expensive, people demand less of it. And that includes employment.

Helping low-wage workers should be a priority. But the best way to help them would be to cut their taxes, reduce regulatory burdens on companies that would otherwise hire them, and allow them to pull their children out of failing public schools. Today Congress threatens to kill them with kindness. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

The Commons: Tragedy or Triumph?

by Bruce Yandle

In the summer I watch ruby-throated hummingbirds fly and hover near a feeder that my wife, Dot, carefully fills with nectar and hangs in view of our kitchen window. The store-bought nectar is colored red, since people think that hummingbirds find that color attractive.

Business around the feeder picks up following rains that wash away the birds' naturally provided food. It is then that the feeder becomes crowded and a hummingbird struggle ensues. Almost always, there is at least one bird that attempts to control access to the feeder—what naturalists sometimes call a dominant male.

The dominant male seeking to maintain control will fly rapidly to the feeder, place his beak into the small openings for a quick draft of nectar, and then fly to a nearby perch where he vigilantly monitors the feeder. When other birds attempt to feed, he quickly tries to intercept and force them away from the stock of sweet food. But while he engages in dogfights with one bird, another often swoops in and takes its fill.

The feeder is a commons, but not just for hummingbirds. Bees are attracted to it as well, and oddly enough, they can drive off the larger hummingbirds. So even if the dominant bird is able to deflect competition from other members of the species, that is not enough to protect the nectar, and the defense itself is costly in energy burned. The feeder contents are never secure.

Hummingbirds have no way to stake a claim to the feeder. So far as we can tell, hummingbird communities have no constitution that reflects socially evolved rules for establishing a social order. Most likely, a long process of adaptation and selection has generated a hummingbird capable of living in a world where nourishment is a common-access resource, a commons. Hummingbirds live a life of flight, engaging in a constant search for nourishment to feed their high-energy lives and, at times, fighting for temporary control over valuable resources.

Human Commons

We all know the tragedy of the commons story. Wonderfully written by Garrett Hardin in 1968, the highly stylized rendering is about a pasture devoid of rules, customs, or norms for sharing.[1] It is open to all comers. In this never-never-land, shepherds logically add sheep to their flocks as long as doing so adds an increment of gain for the particular flock. Uncoordinated in their effort, and unaware of the effects of their individual actions on others, the unconcerned shepherds collectively destroy the pasture. What could be a story of

Bruce Yandle is Alumni Distinguished Professor Economics at Clemson University and senior associate at PERC. *This article is based on a paper presented at a November 1998 UCLA colloquium on Health, the Environment, and Development. The first section is taken from his book* Common Sense and Common Law for the Environment *(Rowman & Littlefield Publishers).*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

plenty, if only the shepherds understood, turns into a story of poverty. The passive shepherds are like hummingbirds.

As Hardin artistically puts it: "Therein is the tragedy. Each man is locked into a system that compels him to increase his herd without limit—in a world that is limited. Ruin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in freedom of the commons."

Garrett Hardin's words beautifully bundle aspects of an endless human struggle to form communities, accumulate wealth, and improve well-being. With that phrase—tragedy of the commons—the essence of the challenge hits us squarely between the eyes: When there are no property rights—formal or informal—that limit use of a scarce natural resource, human action leads inevitably to untimely resource depletion and destruction.

But people are not hummingbirds. People can build institutions that take the edge off frantic commons behavior. People have unwritten and written constitutions that help to establish social order. People can and do accumulate wealth. People communicate, invent lines of kinship, and develop customs, traditions, and rules of law that limit anti-social behavior. People define, enforce, and trade property rights. People can and do avoid the tragedy of the commons. Indeed, instead of living with tragedies, people triumph over the commons. But the triumphs are never perfect or complete. There is always another commons to manage.

The Ascent of Man

I wish to put forward the notion that encounters with the commons form the fundamental stimulus that yields, instead of tragedy, what we today call civilization. The ascent of man from a primitive existence with no wealth accumulation to life as we know it is fundamentally a story about triumph over, not tragedy of, the commons. Let me explain.

Our very existence as human beings is defined by evolved institutions for avoiding tragedies. We have names, which serve the economic purpose of identifying us as parties to contracts and agreements. Those names, first and last, form webs of communication that reduce the social cost of assigning responsibilities and liabilities. They enhance truth-telling and promise-keeping; they raise the cost of engaging in anti-social behavior. They limit a tragedy of the commons.

We have abstract symbols of ownership—deeds, titles, and contracts—that define spheres of autonomous behavior. We speak of our homes, our cars, our clothes, our families, and our pasture. Even language has evolved to provide a possessive form that accommodates triumph over the commons.

We write and observe contracts, wills, and marriage agreements that define relationships, identify turf, and conserve wealth. We accept evolved bodies of law and law-enforcement activities to assure the integrity of our agreements. We carry papers that enable us to acquire property, extinguish debt, cross borders, drive vehicles, and communicate effectively with strangers. And we have locks, keys, walls, fences, brands, and encryption devices, all this in an effort to avoid a tragedy of the commons.

Property rights define who we are and what we have. Property rights guard others from our unwanted advances and prevent us from contributing to a tragedy of their commons.

Avoiding a tragedy of the commons is costly. The benefits must be large.

How has it worked out? Mankind has triumphed over the path to ruin on the commons. Relative to that dewy time when nomadic tribes lived on the commons, we in the Western world live in a veritable Garden of Eden. The pastures are green. The sheep are fat. The clothes racks are full. Where property rights flourish, the choice of food is almost endless. We travel with ease to the four corners of the earth. We communicate electronically at practically no cost. Where is the tragedy of the commons?

The tragedy is found where for reasons having to do with power, intolerance, or cost, human beings have not yet defined private property rights. Or, as we shall see, where evolving property rights encouraged by man the institution builder have been destroyed. What was once a triumph can become a tragedy.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Tragedies Observed and Avoided

It is not difficult to find places where the institution builders have failed. Listen to the description of the situation of the world tiger population. "At the start of the twentieth century, wild tigers were widely distributed throughout Asia, ranging as far west as Turkey, as far north and east as southeastern Russia, and as far south as the Indonesian islands of Java and Bali. There may have been as many as 40,000 tigers in India alone, and the total population may have numbered 100,000 animals. Today, the largest estimate is that the total number of wild tigers is between 4,800 and 7,300."[2] What explains the demise? The same author provides an answer: "Command and control prescriptions for saving the tiger have largely failed because the people who actually determine the destiny of wild tigers have few incentives to save them. . . . We must convert live tigers from liabilities into assets." In short, property rights must be defined.

How might that be done? Consider the description of elephant populations in Kenya and Zimbabwe: In Kenya "poaching has reduced the number of elephants from 65,000 to 19,000 over the last 10 years. To stop the killing, conservation groups . . . called for a ban on the trading of ivory. But the evidence strongly suggests that the ban will only accelerate the destruction of African elephants. In Zimbabwe . . . where ivory trading is legal, the elephant population has thrived, growing at a rate of five percent a year."[3] Why? "In Zimbabwe the revenue from the tusks and hides and a portion of the money made from selling hunting permits go to nearby communities."[4] In short, ordinary people on the ground have a property interest in the elephants. They protect their assets.

What about fisheries? How can we avoid a tragedy of the commons there? Long before the Europeans arrived on the scene in the Pacific Northwest, Native Americans had figured it out. Small tribes in what is now Washington State had salmon fishing rights. Don Leal tells us that "in some cases, the tribe owned the rights; in others, families or individuals or a combination owned the rights."[5]

And what happened when the Europeans arrived? You guessed it. Leal tells the story this way: "Instead of recognizing the well-defined and enforced fishing rights, the U.S. government allowed newcomers to place nets across the mouth of the Columbia. This quickly depleted salmon runs, so traps and weirs were banned—only to be replaced by purse seine boats powered by internal combustion engines. The race to catch salmon moved to open waters. Ironically, from the country where private property is considered sacrosanct came a socialistic legal system driven by politics and military power."[6] What had been private property was turned into a commons. What had been an institution-builder triumph became a political tragedy.

But how can property rights to fish in the high seas be defined? Consider the story of Michael Markels, president of Ocean Farming, Inc. Ocean Farming is in the business of fertilizing the seas to enhance the growth of phytoplankton, which in turn nourishes fish production. Based on actual experiments, Markels estimates that with continuous fertilization about one thousand tons of catchable fish per square mile can be produced each year. "Therefore, 100,000 square miles of fertilized ocean should produce about 100 million tons of fish per year, about equal to the current annual world fish production."[7] So what? Is this all hypothetical?

Ocean Farming has now entered into a contract with the Republic of the Marshall Islands giving the firm an option on up to 800,000 square miles of deep ocean. "Once fish harvesting begins, Ocean Farming will pay RMI $3.75 per square mile of ocean optioned or 7 percent of the value of the catch, whichever is more."[8] In effect, 800,000 square miles of the Pacific Ocean has now been privatized. Ocean Farming can charge other companies to fish the waters, and the firm has agreed to allow artisanal fishing to continue.

Or consider the effort to conserve salmon made by Orri Vigfússon in his native Iceland.[9] Concerned about the systematic decline of the ocean salmon population in the face of rising

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

COURTESY PERC., BOZEMAN, MONTANA

Orri Vigfússon

demand for salmon sport fishing, Vigfússon in 1989 formed the North Atlantic Salmon Fund. Fishermen in Icelandic waters owned quota or rights to fish for salmon. Vigfússon began purchasing those rights and retiring them. His organization now owns the rights to 4,000 metric tons of quota from the high seas, which represent 95 percent of the exiting quota. The result: the demise of the salmon is ended, highly profitable sport fishing is flourishing, and the tragedy of the commons has been avoided. Oddly enough, Vigfússon's efforts to introduce a similar approach in New England, where unsuccessful efforts to restore wild salmon have been underway for 140 years, fell on deaf ears. Some might describe the New England situation as a tragedy of the commons. It is not. It is a tragedy of failed institution building.

Water and Air Pollution

What about water and air? Can the institution builders help us avoid a tragedy of the commons for these unowned resources? The answer is clearly yes, they can help, but the solutions are never perfect.

For centuries before anyone in the United States thought much about environmental quality, our common law defined and protected the environmental rights of ordinary people.[10] Enforced by judges in courts across the land, common law protected the right of downstream property owners to receive water and air in undiminished quality for reasonable use. At common law, rivers could not be treated as open sewers if doing so imposed costs on downstream rightholders. Industrial plants could not blow smoke and emissions onto the land and property of ordinary people. The record is filled with cases, here and in Canada, decided under English common-law traditions: where farmers sued industrial plants and won; where citizens of one state sued polluters in another state, and won; and where common-law judges ordered polluters to clean up or shut down. There are also cases where this did not happen, where judges turned away from property-rights enforcement and behaved as policy makers. But when the judges got it wrong, their decisions affected a small number of people, not an entire nation. This, of course, changed with the advent of legislation.

Prior to the passage of federal pollution-control statutes, every major city in the United States had taken steps to define public property rights to air quality. Many states, including California, had taken a river-basin approach to the management of water quality, this in addition to the use of common law. Multi-state compacts were forming. By the 1960s, environmental quality was improving rapidly in many locations. The property rights institution builders were on their way to avoiding a tragedy of the commons. Common law was converting the commons to private property.

This was changed with the passage of federal legislation that effectively nationalized air and water quality in the United States. What was becoming private property was made public property, almost a commons. The new system of command-and-control regulation allowed polluters to operate legally if they had a permit. With permits in hand, new polluters could enter already crowded river basins. The new regime provided political access to industries and municipalities that hoped to postpone the day of reckoning in common law courts. Environmentalists ran interference, since they typically preferred

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

political solutions to remedies based on property rights, markets, and the rule of law. A triumph on the commons was reversed. Tragedy once again reared its head.

On the frontispiece of Rachel Carson's epoch-making book, *Silent Spring*, one finds these words from Albert Schweitzer: "Man has lost his ability to foresee and forestall. He will end by destroying the earth."

Such pessimism expressed by such an imminent and sensitive thinker gives us pause. What was Schweitzer thinking about when he uttered those words so many decades ago? And how is it that at least so far, his damning forecast has not come true?

About a year ago, a colleague and I began an investigation of air and water quality for a sample of countries worldwide.[11] We gathered data on income, life expectancy, and property rights enforcement for 14 countries. Our results replicated previous work that showed a systematic relationship between improved environmental quality and incomes after a certain income threshold was passed. Our new finding was that where property-rights enforcement is stronger, environmental quality is better.

This work sheds light on mankind's struggle to avoid the tragedy of the commons. It tells us that at very low levels of income, what might be called stage one, human beings cannot afford to do much about property-rights enforcement and the commons. They live in a world where custom and tradition sustain them. As incomes rise and losses from the commons expand, stage two is entered. Fences go up, and rules are set for protecting the commons. Finally, in stage three, markets evolve along with rules of law that define spheres of private and public action. Private rights replace public control, and the triumph replaces the tragedy of the commons.

Life for mankind began on a commons where tragedies were commonplace and the incentive to improve was powerful. Out of the struggle to survive and accumulate wealth evolved markets, property rights, and the rule of law—a triumph on the commons.

But just as bees compete with hummingbirds in the struggle to control access to nectar, institution builders who seek to support markets and property rights compete with others who seek to redistribute wealth. Actions to redistribute wealth blunt the incentive to protect property rights and create wealth. This converts triumph to tragedy.

Human beings can and do avoid the tragedy of the commons. But doing so requires property rights and markets, which must be defended if the triumph is to continue. □

1. Garrett Hardin, "The Tragedy of the Commons," *Science* (162) 1968, pp. 1243–48; it's available at http://www.cs.colostate.edu/~heckendo/tragedy.html.
2. Michal t' Sas-Rolfes, "Who Will Save the Tiger?" PERC Policy Series, PS-12, February 1998, p. 2.
3. Terry L. Anderson and Donald R. Leal, *Free Market Environmentalism* (San Francisco: Pacific Research Institute, 1991), pp. 67–68.
4. Ibid., p. 67.
5. Donald R. Leal, "Community-Run Fisheries: Avoiding the Tragedy of the Commons," PERC Policy Series, PS-7, September, 1996, p. 4.
6. Ibid.
7. Michael Markels, Jr., "Farming the Oceans: An Update," *Regulation*, Spring 1998, p. 10.
8. Ibid.
9. Orri Vigfússon, "How Markets Save Salmon," *PERC Reports*. September 1998, p. 9.
10. Roger E. Meiners and Bruce Yandle, "Common Law Environmentalism," *Public Choice* (94), 1997, pp. 49–66.
11. Bruce Yandle and Xiang Dong Qin, *Environmental Kuznets Curves, Property Rights and Learning*" (Clemson, S.C.: Center for Policy & Legal Studies, 1998).

We are helping
FEE
sell books over the Internet
hosted by 3D RESEARCH OK
May We Help You?
3D RESEARCH
http://fee.3dresearch.com web@3dresearch.com
(724)-776-7384

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Economics

Second-Guessing the Market

by John A. Sparks

We commonly think of people below the poverty line as the only beneficiaries of welfare. But poor families are not the sole recipients of government money. Some of America's largest and most successful companies get welfare checks just as certainly as do millions of single mothers. General Electric, GM, DuPont, IBM, and Armstrong World Industries are just a few of the firms that have garnered government grants provided through the Department of Commerce under something called ATP, Advanced Technology Program.[1] The department has just approved another round of grants totaling $236 million for business-participants in 79 new research and development projects.[2]

The aim of ATP sounds laudable. It was created a decade ago to develop new technological ideas that could be used by U.S. businesses to make themselves more competitive on world markets. Under the program, firms file grant proposals with the National Institute of Standards and Technology (NIST), an arm of the Commerce Department. NIST selects the most promising proposals for federal money. Businesses winning grants must agree to risk some of their own money, usually an amount roughly equal to Uncle Sam's share.

John Sparks is chairman of the department of business administration, economics, and international management at Grove City College in Pennsylvania.

Winning Proposals

What kinds of projects command the federal cash? Here are some examples from the most recent awards. General Electric received over $1.5 million to develop "amorphous silicon devices" for use in medical imaging systems. It also got $482,000 to work on using synthetic sand to produce fused quartz, a component of semiconductors. A California outfit called DemoGraFx managed to win a $2 million grant, which it promised to use to develop systems that will help digitize motion pictures. Another business, Seaward International, Inc., will use its nearly $2 million to develop plastic railroad ties to replace the old-fashioned wooden creosote-soaked variety. Taxpayers also footed the bill for research and development work in the realms of microturbines, superfingerlings, spinal cord injuries, propane fuel cells, and a host of other endeavors.

Why do these companies need taxpayer money to further their research and development efforts? Recipient firms say that they would not be able to raise enough capital from private sources to finance such unproven ventures. DemoGraFx is typical. In its successful bid for government funds to finance research for digitizing theater films, it said that "the high-risk nature of developing a system that meets industry's needs for quality and security has deterred investment."[3] How does this claim stand up to economic analysis?

The economics of capital convertibility, which is what companies engage in when they consider new technological ideas, is relatively simple. Every kind of enterprise, from the simplest to the most complex, possesses capital goods (machines, tools, and equipment) that are based on certain technological ideas. As Ludwig von Mises pointed out, production is always being carried out with the "then prevailing ideas concerning ends and technological procedures."[4] However, new technological ideas are always surfacing that present the businessman with a dilemma: Should he continue to use existing capital goods to produce his product or service, or should he adopt the new technology and either scrap the old capital goods or use them less? Again, as Mises

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

argued: "The choice rests, as it always does in the market economy, with the consumers."[5] Will consumers recognize the superiority of new products promised by the advanced technology? Will they pay a price for the "new, improved" version that will be sufficient to compensate the businessman for the costs of the technological change? "The absence of a sufficient degree of superiority to make the cost of transformation possible," Mises wrote, "is proof of the fact that consumers are more intent upon acquiring other goods than upon enjoying the benefits of the new invention."[6]

Now back to the ATP applicants. Each business-applicant presumably went through its own internal review to determine if the response of consumers to the new technology would warrant the added capital investment in the idea. For example, the managers of DemoGraFx undoubtedly asked themselves how movie houses would respond to digitized motion pictures. Would they be especially attracted to the truer reproductions and to the reduction in fading over time? More importantly, would they pay enough more for the digitized copies to cover the increased capital costs? The answer to that question appears to have been no.

Undoubtedly, the other businesses that submitted requests for ATP funds went through similar calculations and came to similar conclusions. Their own boards apparently refused to use internally generated capital to bankroll the R&D projects at levels that would move them forward. If the firms then sought capital from outside investors, they too gave the research project a thumbs down—at least at the levels of funding sought.

Now, these facts reveal the first objection to ATP. Businesses that submit their ideas to NIST for financing present projects that they themselves have already determined to be *unpromising* according to ordinary market criteria.

Accelerating Development

But, counters NIST: "ATP support significantly accelerates potentially important R&D projects. . . . [A]ccelerated R&D is critical to eventual economic success in the highly competitive global market."[7] ATP does accelerate the research projects that receive the government money. However, this acceleration should not be confused with economic progress. The "acceleration" is not in response to true consumer demand. Neither is it consistent with the true costs of capital. The market counsels postponement of these projects until conditions of demand and cost are more favorable. ATP ignores this counsel and denies the true configuration of demand and capital costs. ATP nullifies the assessment mechanisms by which the rest of the business world determines which projects are worth pursuing. Therefore, ATP of necessity wastes precious capital on projects that applicants have already denominated as unripe, premature, and unsuitable for development at this time.

The second objection to ATP is related to the first. Not only is capital forced into projects that real-world conditions have branded as uneconomic, but that capital must first be confiscated from other citizens through taxation. To the extent that they win ATP grants, business firms make all U.S. taxpayers, including other small, medium, and large businesses, into unwilling investors in their shaky undertakings. The managers of the ATP recipient firms mentioned here would not think of taking funds by force directly from their fellow industrialists to help finance their research projects. Yet when they participate in ATP they are doing that by indirection and political means. □

1. Project Briefs describing each successful project by General Electric, General Motor, DuPont, Armstrong World Industries, and the other enterprises mentioned in this article can be found at the National Institute of Standards and Technology Web site at http://www.atp.nist.gov.

2. "79 New R&D Projects Selected for 1998 Advanced Technology Program Awards," http://www.atp.nist.gov/www/press/g98-74.htm.

3. "Integrated Layered Compression System Prototype: Project Brief," http://www.atp.nist.gov/www/comps/briefs/98040006.htm.

4. Ludwig von Mises, *Human Action* (New Haven: Yale University Press, 1949), p. 504.

5. Ibid.

6. Ibid., p. 508.

7. "79 New R&D Projects."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Money in the 1920s and 1930s

by Richard Timberlake

One of the most enduring and troublesome mysteries in economics is money: how it is created, what sorts of institutions initiate the process, what kinds of mystique and priestcraft central bankers use in managing monetary systems, and what rules, laws, or customs limit their actions.

Perhaps the common ignorance about money is harmless. After all, the millions of people who use this money drive sophisticated automobiles and manipulate complex computers without knowing much about the technical properties of either. As long as cars, computers, and money behave themselves, can we perhaps ignore them? The answer is that we can for cars and computers but we should not for money.

For one thing, ignorance about money has side effects that are not comparable to ignorance about technical equipment. Competitive markets drive the production and sale of all household durables, but the production of money in every country in the world today (and yesterday, too) is the province of governments. Through the offices of their associated central banks, states monopolize the machinery of money. Each central bank determines within very close tolerances just how much money an economy has and the rate at which the current stock of money will change. Unquestionably and inevitably, political pressures that are rarely visible even to experienced observers influence these operations.

Because they have the power to create money without license, governments also have the complementary incentive to claim that depressions and inflations resulting from the mismanagement of money occur because of unusual and unexpected economic developments—"shocks," as they are labeled. The term implies a sense of impending and inevitable drama. No such social catastrophes result from the public's incomplete knowledge of computers and automobiles, nor of "shocks" that might affect their production and distribution. However, neither do governments monopolize that production and distribution, and therein lies the difference.

Fateful Decades

Nowhere is monetary ignorance more apparent than in bystander evaluations of the economic and monetary events of the 1920s and 1930s. Although several decades have passed, the various popular accounts continue to misinterpret the causes of the disequilibrium that occurred and also the federal government's aggravation of the problem. Government apologists of many persuasions not only argue that the massive interventions of the 1930s were necessary; they also contend that the lack of response in the private sector to the multitudinous government programs put into

Richard Timberlake is a professor of economics retired from the University of Georgia, and author of Monetary Policy in the United States, An Intellectual and Institutional History *(University of Chicago Press, 1993). This article is the first in a series.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

place proved that the economic system was moribund.

Nothing, they argue, could have prevented the debacle. They encourage the popular belief that the market economy zealously overextended itself in the 1920s. The boom, they contend, led to the stock market crash in 1929, and to the several banking crises of the early 1930s. These financial failures, the legend continues, provoked exhausting industrial liquidations, and the other devastations of the 1930s. The role that the central bank—the Federal Reserve System—and its managers played in the catastrophe of the 1920s and 1930s is largely unknown and therefore unappreciated.

Other observers, for example, many Austrian economists, believe that all the trouble started with a central bank "inflation" in the 1920s. This "inflation" had to be invented because it is a necessary element in the Austrian theory of the business cycle, which seems to describe most Austrian economic disequilibria. Austrian "inflation" is not limited to price level increases, no matter how "prices" are estimated. Rather, it is any unnatural increase in the stock of money *"not consisting in*, i.e., not covered by, an increase in gold."[1]

Once the Austrian "inflation" is going, it provokes over-investment and maladjustment in various sectors of the economy. To correct the inflation-generated disequilibrium requires a wringing-out of the miscalculated investments. This purging became the enduring business calamity of the 1930s.

The late Murray Rothbard was the chief proponent of this argument. Rothbard's problem is manifest in his book *America's Great Depression*. After endowing the useful word "inflation" with a new and unacceptable meaning, Rothbard "discovered" that the Federal Reserve had indeed provoked an inflation in the 1921–1929 period. The money supply he examined for the period included not only hand-to-hand currency and all deposits in commercial banks adjusted for inter-bank holdings—the conventional M2 money stock—but also savings and loan share capital and life insurance net policy reserves. Consequently, where the M2 money stock increased 46 percent over the period, or at an annual rate of about 4 percent, the Rothbard-expanded "money stock" increased by 62 percent, or about 7 percent per year.[2]

Here, Rothbard mistakes some elements of financial wealth with money. The latter two items he specifies as money are not money. They cannot be spent on ordinary goods and services. To spend them, one needs to cash them in for other money—currency or bank drafts. Increases in their quantity do not pervasively spill over into all other markets causing serious macroeconomic disequilibrium. Their appearance as financial assets in people's possession is just as likely to be deflationary as not, because their purchase and sale require money that would otherwise be used for transactions of conventional goods and services.

Apologists for central banking, by way of contrast, see stock market "speculation" instead of over-investment as the culprit. They argue that the Federal Reserve System did all it could to counteract the "inevitable" contraction that followed the 1929 stock market boom, but that its best effort could not be good enough. Since earnest and sophisticated men operated the federal government and the Federal Reserve System, something had to be wrong with the economic system itself. Markets just could not be trusted to provide full employment and steady real growth.

The Mismeasure of Money

Careful scrutiny of the monetary system and its associated monetary data reveals that neither of these views is analytically correct. Their defects result from ignorance of the flawed institutional framework within which the gold standard and the central bank generated money. Both also suffer from mismeasurement of the central bank's monetary data.

Four definable institutions created the money in use during the 1920s: the gold standard, the U.S. Treasury, the Federal Reserve System of 12 regional banks and the Federal Reserve Board in Washington, and the commercial banking system of 20,000-odd banks. These institutions were not created equal,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

however. Only the gold standard and the Fed, with a notable assist from the Treasury, were important in initiating either monetary policy or the monetary happenings of the period. The commercial banks could only take what came their way from the central bank and the gold standard. They, too, created money. But their money-creating activities were all unintentional and strictly a byproduct of their lending operations.

The gold standard after World War I was anything but the autonomous, self-regulating institution that the Founding Fathers had prescribed—quite the contrary. The Federal Reserve Bank officers, particularly presidents, and the governors on the Federal Reserve Board, based then in the Treasury Building in Washington, exercised a monetary policy that often finessed the gold standard.

When gold came into the U.S. economy from a foreign country, importers deposited it in a commercial bank. The commercial bank in turn sent the gold to the regional Federal Reserve Bank to which the commercial bank belonged. The Fed Bank would credit the reserve account of this member bank, credit its own gold asset account by the same amount, and deposit the physical gold in the Treasury. If the member bank needed currency instead of an additional balance in its reserve account, the regional Fed Bank would issue its own Federal Reserve notes, dollar for dollar, based on the gold it had received. In either case, the Fed Bank was simply a monetizer of the gold. It converted the gold into dollars just as an ordinary commercial bank would have done in the absence of a central bank.

The monetary system thereafter had more dollars of bank reserves and deposits, or dollars of currency, because gold had come into the country. All other legal tender items, such as silver currency and greenbacks, were accounted in the Fed Banks in the same way as the gold. Fed Banks, therefore, were the custodians of a large fraction of the economy's basic money stock—the currency and bank reserves behind the checking accounts that households and businesses used for everyday transactions.

Blocking the Effects of Gold

Of course, the Federal Reserve System did not come into existence to be a custodian of the economy's base money and nothing else. The Fed Banks also had the legal power to create bank reserves and currency. Using the gold and other legal tender they held as *their* reserves, the Fed Banks could themselves become fractional reserve institutions. They could expand the reserves of their member commercial banks, or issue additional currency to them, by buying certain interest-earning "eligible" assets from the banks. If Fed Banks wished to block the effects of gold deposited with them to prevent the creation of common money based on the new gold, they could restrict their own lending to the commercial banks or sell off some of their interest-earning assets. Within limits, the Fed's money managers could deliberately and purposively supplement or counteract what the gold standard machinery did as a result of market forces. It was this particular machination to which Rothbard properly objected.

The Fed Banks' institutional authority derived from the Federal Reserve Act of 1913. The Act gave the Fed Banks the role of sequestering most of the banking system's gold, and the power, explained above, either to enhance or hinder the monetary effects of any incoming gold. At the same time, the congressional founders of the Fed saw the new institution only as a supplement to the official gold standard. In the Federal Reserve Act itself, they inserted a provision stating: "Nothing in this act . . . shall be considered to repeal the parity provisions [between gold and the dollar] contained in an act approved March 14, 1900." That referred to the Gold Standard Act, which made gold the sole legal tender monetary metal in the U.S. system. The new Federal Reserve System was supposed to act only within this official gold framework.

To show how the Fed's hands-on controls worked during the 1920s, I have constructed a table that summarizes the major monetary elements in the combined Fed Banks' balance sheet for the 1921–1933 period. It also includes the level of prices as measured by the Consumer Price Index (CPI).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The column labeled M1 measures the stock of common money—currency and checking account balances. From 1921 to 1929 this stock of everyday money increased on average 2.5 percent per year (compounded).[3] The column labeled "Total Fed" shows the Federal Reserve base on which this common money rested. Although this base increased slightly from 1924 to 1928, it *declined* over the whole eight-year span at an annual rate of 1.6 percent.

Fed-held gold and other reserve assets increased nominally at 1.1 percent per year primarily because of gold inflows. Federal Reserve policy prevented some of this gold from becoming a basis for new money by "sterilizing" it. That is, as the gold came into their tills, the Fed Banks allowed their holdings of other assets, which were primarily debts of the member banks, to decline: The member banks paid off some of their debts by reducing their reserve account balances at the Fed Banks. Changes in "net monetary obligations" of the Fed Banks (the column labeled "Net Fed") accurately reflects this deflationary policy. "Net monetary obligations" are total monetary assets minus gold and other legal tender reserves. This datum, which faithfully indicates the *intent* of Fed policy, *declined* at an annual rate of 8.0 percent over the eight-year period.

Fed policy successfully offset the gold inflows so that prices rose only slightly—0.5 percent per year for the eight-year period. This much of a change can hardly be labeled an "increase" because it is less than the statistical construction error of the index. One thing is certain: it was *not* any kind of an inflation. All the economic chronicles for the period, besides the monetary data, confirm that Fed policy was braking against possible gold-inspired price increases in the United States. The Fed's primary purpose was to further international monetary policies, particularly to help the Bank of England achieve and maintain gold payments for the pound sterling—but that is another story.

In their *Monetary History of the United States,* Milton Friedman and Anna Schwartz conclude their summary of the monetary events of the 1920s with this paragraph: "Gold movements were not permitted to affect the total of high-powered money [bank reserves and currency]. They were . . . sterilized, inflows being offset by open market sales, outflows by open market purchases."[4] They observe further: "The widespread belief that what goes up must come down, . . . plus the dramatic stock market boom, have led many to suppose that the United States experienced severe inflation before 1929 and [that] the [Federal] Reserve System served as an engine of it. *Nothing could be further from the truth.* By 1923, wholesale prices had recovered only a sixth of their 1920–21 decline. From then until 1929, they fell on the average of 1 percent per year. . . . Far from being an inflationary decade, the twenties were the reverse. And the Reserve System, far from being an engine of inflation, very likely kept

Money, Monetary Assets, and Liabilities of the 12 Fed Banks, and Prices (1947–49=100), 1921–1929, and 1929–1933

Years	M1	% yr.	Total Fed	% yr.	Fed Gold	% yr.	Net Fed	% yr.	Prices
1921	21.0	—	4.79	—	2.63	—	2.16	—	76.4
1929	26.2	2.5	4.25	–1.6	2.86	1.1	1.39	–8.0	73.3
1933	19.2	–9.1	5.63	8.1	3.56	6.1	2.07	12.2	55.3
($ billions, except prices)			**(a)**		**(b)**		**(c)**	**note: (a) = (b) + (c)**	

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the money stock from rising as much as it would have if gold movements had been allowed to exert their full influence."[5]

Ironically, the Federal Reserve System that has provided itself in recent decades with the well-deserved label "engine of inflation" was in the 1920s an "engine" preventing gold inflation. Any gold inflation would have been very mild; so the question of whether Fed policy was proper is arguable—until we look at what happened afterward.

Given that its intervention prevented a minor gold inflation, did the Fed then reverse itself as bank failures occurred and economic contraction threatened? Following approved central bank doctrine, did it lend freely during the ensuing contraction at stiff interest rates until its remaining gold reserves would not have been enough to plate a teaspoon?[6] Let's see what happened.

Disaster Hits

As everyone knows, the following four years, 1929–1933, were a deflationary disaster. Not quite so clear is what the Federal Reserve did, or, more important, did not do during that time. Fed spokesmen have often alleged that the Fed tried "everything in its power" to turn around the contraction, and that it used its gold reserves to their utmost. Again, nothing could be further from the truth.

By 1929, the Fed's monetary liabilities—commercial banks' reserve-deposit accounts in Fed Banks, and the public's holdings of Federal Reserve currency—were $4.25 billion. These monetary items exceeded the Fed's gold asset holdings by only $1.39 billion. Put another way, the gold that came into the Fed Banks, which the commercial banks would have held in the absence of a central bank, was $2.86 billion. Federal Reserve policy actions had created the remaining $1.39 billion. By August 1929, the Fed's gold and other reserves had grown to $3.12 billion (not shown in the table). The Federal Reserve Act required half these gold reserves to back outstanding Fed liabilities, but the other half of them, $1.56 billion, were "excess" and available for whatever monetary purposes the Fed managers thought appropriate.

During the following three-and-a-half years, the Fed Banks' managers continued to build up the Fed Banks' gold holdings—even as the financial system spiraled downward as a result of three serious banking crises. By February 1933, owing to the Fed's tight money policy, the economy was in shambles and constricted to the point of monetary suffocation. The Fed Banks' gold stock had *increased* to $3.36 billion, and "excess" gold reserves were still $1.35 billion! (The higher figure in the table is for June 1933.) This damning statistic is seen in the column labeled "Fed Gold." While the Fed had enjoyed an increase of $700 million in its gold and other reserve holdings, its monetary output had increased by only $680 million: Commercial banks had $20 million *less* in reserves than they would have had with no Federal Reserve System.

This statistic, however, is not the end of the story. Since total commercial bank reserves were $2.29 billion in February 1933, the $1.35 billion of excess gold reserves Fed Banks held could have enhanced the banking system's reserves by another 60 percent—to $3.64 billion.

"Real Bills Doctrine"

The Fed Banks were truly absorbers of gold. They simply extended and intensified the tight money policy they had begun in the 1920s, but for a different reason. Instead of helping the Bank of England return to a gold standard, the Fed managers had become enthralled with the idea that production of goods and services initiates and promotes the production of money. Economists sometimes refer to this as the "real bills doctrine." While it has a grain of truth in it when a true gold standard is in place, it has no validity at all in a system dominated by a central bank. With this flawed doctrine governing their thinking, the Fed Banks' managers marked time waiting for new production to appear so that they could in good conscience expand their monetary obligations in support of the private economy.

It never happened.

The U.S. banking system went through three serious contractions and the money

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

stock continued to shrink. By 1933, the M1 and M2 money stocks were 27 percent and 25 percent below their 1929 levels. Meanwhile, the Fed Banks sat on their huge hoard of gold—the gold reserves legally required for their current monetary output and the "excess" gold reserves that could have provided significant monetary increases—and did . . . nothing!

Truly, when such a crisis appears, *all* the central bank's gold is excess. A proper central bank can never be faulted for "running out of gold." If the Fed Banks had followed the established (Bagehot) doctrine of the time, they would sensibly have expanded their loans, discounts, and accommodations to their "member" banks until their gold stock was a cipher.

Of course, they would not have had to run their gold reserve ratio down to zero. Long before they had expanded or used up their gold reserves, the crisis of central-bank mismanagement would have ended (or, more probably, would never have begun). The economy would have been back to normal, and none of the ugly governmental machinations of the later 1930s would have occurred. No Supreme Court conflicts would have appeared; no New Deal bureaucracies would have emerged to plague the economy; the Leviathan would have been kept in its constitutional cage. Most important, many of the freedoms we are now trying to restore would still be commonplace.

One would think that with this experience behind them, the "monetary authorities" and the congressional wheelers and dealers would have learned some lessons about U.S. monetary machinery and its relationship to the economy. They did not.

Next month I will treat the reserve requirement debacle of the mid-1930s, which added additional travail to the monetary mistakes made in the early part of the decade. □

1. Murray N. Rothbard, *America's Great Depression* (Kansas City: Sheed and Ward, 1963, 1972), p. 87. Emphasis in the original.
2. Ibid., p. 88.
3. The M2 money stock, which includes all of M1 plus time deposits at commercial banks, increased 5 percent per year from 1921 to 1929, and then fell at 13 percent per year from 1929 to 1933. No basis exists for a more inclusive money stock than M2.
4. Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton: National Bureau of Economic Research and Princeton University Press, 1963), p. 297.
5. Ibid., p. 298. Emphasis added.
6. This well-understood doctrine for central bank procedure was proposed by Walter Bagehot in his classic work, *Lombard Street*, rev. ed. (London: Kegan, Paul, Trench, Toubner & Co., 1906 [1873]).

THE FREEMAN
Ideas On Liberty

1998 Bound Volume

The 12 issues from January through December 1998 have been gathered into a single volume—sturdily sewn with navy blue cloth cover and gold foil stamping—768 pages, fully indexed for handy reference to the latest literature of freedom. More than 100 feature articles on topics such as antitrust, education, environment, government regulation and control, health care, individual rights, labor, money, private property, and international trade. Columns by Walter Williams, Mark Skousen, Larry Reed, Dwight Lee, Doug Bandow, and Chuck Baird. Reviews of more than five dozen books—and all the 1998 issues of *Notes from FEE* by Don Boudreaux.

$24.95 each

Save! Special introductory price: $19.95, through April 30, 1999

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Inscrutable Follies

"Don't bother to examine a folly—ask yourself what it accomplishes."
—AYN RAND, *The Fountainhead*

Pardon if I sound like a character out of Dostoyevsky, but is it a sign I am mad when I am unable to understand what should be a simple newspaper article about taxing and spending in Washington?

A *New York Times* article on January 15 began: "The Clinton administration plans to propose a federal tax increase of 55 cents a pack on cigarettes to help pay for new domestic and military spending programs, White House and congressional officials said on Thursday."

The tax increase is estimated to yield $8 billion a year. Tax revenues have been rising 8 percent a year since 1992, but that's not enough for the people who spend our money for us.

That sentence was followed two paragraphs later by this: "The president has not announced how he intends to pay for these programs, promising that the details would be provided in the budget he submits to Congress on Feb. 1. But the White House has long signaled its intention to seek more money from tobacco, and officials confirmed a report in the *Wall Street Journal* on Thursday that Clinton will propose the tobacco tax, which is now at 24 cents, as part of a package of tax increases and loophole-closings that it intends to push to pay for new programs."

I guess a distinction can be made between "White House officials" saying something and a presidential announcement to the same effect. In Washington the trial balloon is a common device for testing the reaction to proposals before anyone is publicly committed to them. It makes sense to use trial balloons, considering all the surplus hot air they have there.

Nevertheless, this is unnecessarily confusing. Does Clinton favor raising tobacco taxes to pay for new government spending or not? Of course he does.

The *Times* goes on to say: "Clinton plans to discuss in the State of the Union address next week his administration's efforts to reduce smoking by teenagers, including the proposed tax increase to make cigarettes too expensive for some potential smokers."

Here we go again. Is the tax supposed to raise money or isn't it? If it discourages smoking, how can it finance new spending? The administration won't say, and the reporters don't even bother to point that problem out. They accept the contradictions and pass them along to us, assuming we won't notice.

Incidentally, if it's so terrible for tobacco companies to profit off people's lethal habits, why isn't it just as terrible for politicians to do so?

Sheldon Richman is editor of The Freeman.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The article then broadens its focus from tobacco to the budget in general: "Despite growing federal budget surpluses—Clinton announced earlier this month that the government would take in at least $76 billion more than it spends this year—the administration has been forced to scramble to come up with money to pay for a long list of initiatives that it will include in the budget proposal it will send to Congress."

Translation: The government can never have enough money. Reports of the death of big government have been greatly exaggerated. And by the way, if you exclude the Social Security accounts, there is no surplus. The budget will be in deficit at least through 2001. The surplus is the result of the onerous FICA tax (for Social Security and Medicare), which exceeds 14 percent and is applied to more and more of our income each year. The proceeds not needed to pay retirees are used for general government spending. In a couple of decades, with the retirement of the baby boomers, that surplus will turn into a deficit.

The *Times* explained that "the administration is the victim of its own success" in that Clinton and the Republicans agreed to protect the surplus pending a solution to the coming Social Security bankruptcy. "Moreover," added the *Times*, "both Congress and the administration remain bound by budget rules that presumed the government would always run deficits."

The *Times* implied the agreement not to touch the Social Security surplus was kept. Not so, as the astute James Glassman pointed out: "last year we got a good demonstration of what politicians of both parties do with a surplus. They spend it—often on pork-barrel projects such as the highway bill or on subsidies to favored groups such as farmers. . . . In his State of the Union address [in 1998], President Clinton said he would reserve 'every penny of any surplus' for Social Security. Instead, joining with Republicans, he boosted federal spending by an extra $20 billion, getting around budget rules by calling the new outlays an 'emergency.'" In other words, they lied—well, misled us.

The *Times* and Glassman both mentioned the budget rules. They deserve some attention.

From the *Times* story: "Those rules impose tight spending caps. . . ."

Obviously not tight enough if new spending can be exempted merely by labeling it "emergency." Nevertheless, the *Times* informed us that "The spending caps for next year are about $30 billion less than Congress would need to pay for all current programs—never mind any new ones [!]—and politically palatable sources of new revenue are scarce."

So the budgeters should be cutting spending, right? Guess again.

The rules, continued the *Times*, "require that any tax cuts or credits be offset by corresponding tax increases." Come again? All tax cuts must be offset by tax increases? This is where I really begin to feel I'm in the Twilight Zone. Who came up with these rules? Do they take us for fools? The state giveth, the state taketh away—simultaneously.

One more passage from the *Times* article: "In addition to the tobacco tax, Clinton plans to include a number of other proposals to close corporate tax loopholes or otherwise squeeze more revenue from the tax system, even though Republicans routinely denounce them as dead on arrival. But in the end, the proposals allow Clinton to say he is submitting a balanced budget that sets out his policy agenda."

"Closing tax loopholes" is a euphemism for raising taxes. Business, goes the old saw, doesn't pay taxes; it collects them. Thus, *we* are to be imposed on further by the government's voracious appetite for revenue. But we won't notice. And the budget will be in balance—if you hold the mirrors at just the right angle.

Government goes to great lengths to shroud its activities, and the national media are partners in the crime. They may focus on scandal and undo a rogue from time to time. But essentially they are conspirators in the building and maintenance of the consensus interventionist government requires.

Making sense of what government is up to is wearisome, which is the point. The proprietors of the budget don't want us looking over their shoulders. What shepherd ever wanted advice from his flock? □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

James F. Lincoln: Industrial Peacemaker

by Daniel Hager

The dichotomy between labor and management does not actually exist. Enlightened self-interest eliminates contentious factionalism in employment relations. Unfortunately, government has intervened in the workplace to convert it into a battleground and to institutionalize coercive conduct that is akin to warfare. The victims are consumers and the entire American economy.

Those were the views of an industrialist named James F. Lincoln. He applied what he termed "incentive management" in building the Lincoln Electric Co. of Cleveland, Ohio, into the world's largest manufacturer of arc-welding equipment. Lincoln Electric was a provider of top-quality products at prices that undercut the competition. Nevertheless, it paid its workers at about twice the average wages in the overall industrial sector and weathered the New Deal.

Lincoln, who died in 1965 at the age of 82 and hence was spared the Great Society's additional hamstringing of employers, was as harsh on "ultraconservative" industrialists who saw workers as adversaries as he was on misguided government. His management philosophy combined the Golden Rule with athletic metaphors. As he explained in his 1961 book, *A New Approach to Industrial Economics*, application of the Golden Rule leads to the type of cooperation that characterizes successful athletic teams, where the coaches and players are not antagonists but all pull together for the common goal of victory.

Everyone's a Manager

In any organization everybody actually embraces both management and labor functions: "All are managers when they operate a machine, an assembly line, a broom, or a punch press, or when they manage the financial, economic, and social activities of the company. All also are labor. Some operate machines, some operate assembly lines, some operate brooms, and some operate the activities with government, with sellers, with buyers, and with the public. There can be no dividing line drawn between them. All are essential to the business and are complementary in their work."[1]

Lincoln learned about individual development and voluntary cooperative accomplishment while studying electrical engineering and playing football at Ohio State University, where he captained the undefeated 1906 team. The next year, he became a salesman at the small struggling electrical company managed by his brother, John C. Lincoln, a better engineer than businessman. In 1914 at age 31, James Lincoln moved up to general manager of Lincoln Electric and later became president. He solicited employees for advice believing that no one person can know everything and that others have much to contribute.

Development of employees' talents became his goal, based on the foundation that "free-

Daniel Hager is a freelance writer in Lansing, Michigan.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

dom of the individual is essential. Freedom means responsibility. It means opportunity. It means pride in ourselves and the place that we have created for ourselves in the world. No free man ever allowed himself to infringe on the rights of others."[2]

His strategies excluded production speedups and even conventional profit-sharing plans, which depend on too many factors beyond the control of individuals to provide them incentives. The *New York Times* obituary quoted Lincoln's core policy: "There is no limit to the production capacity of a human being. The worker who is assured the fruits of his labor will find a thousand and one ways to increase production."[3] The workers themselves devised methods to improve productivity and reduce costs and benefited directly from their efforts.

The system of rewarded innovation worked so well that the labor required to produce a 200-amp welding machine dropped from about 113 hours in 1921 to about 16 in 1944. The selling price fell from $1,500 to $200. Between 1932 and 1943 worker productivity increased almost 13 times. Wholesale prices of manufactured goods rose more than 40 percent over that span, but prices of Lincoln's arc welders were cut in half or more.

Lincoln said that "The goal of an organization must be this—to make a better and better product to be sold at a lower and lower price. Profit cannot be the goal. Profit must be the by-product."[4] His company paid liberal dividends throughout the Depression and laid off no workers. Work stoppages were inconceivable, even in the post-World War II era when strikes by organized labor became an everyday occurrence. Lincoln Electric's productivity per worker and annual worker compensation were about double the entire manufacturing sector following the war.

Sued by the Government

During the New Deal, when corporate taxes were high and personal income taxes still low, the federal government sued Lincoln Electric on grounds it paid its employees too well. The case dragged on through the war years. Lincoln asked if the firm would have been sued if it had twice as many employees producing

James F. Lincoln

equal output at half the pay. When he was told no, he countered that the "crime" for which he was being fined was that he had freed up 2,500 people to work in the war effort elsewhere.

Government interference crimps productivity and creates poverty, as further exemplified by the Wagner Act, Lincoln noted. He described collective bargaining as "civil war." In contrast to incentive management's cooperation, under the Wagner Act "government sets up on one side of a table a group of people called 'management,' on the other side a group of people called 'labor,' orders them to fight until one or the other gives in and signs a contract dictated by the winner. . . . The fact that a conflict is forced by the philosophy of collective bargaining dooms the result to failure. . . . Cooperation is killed in the struggle and progress of the company is stopped. There has never been any collective-bargaining fight that did not end with higher cost of production. There has never been a collective-bargaining fight that did not result in a loss to the consumer."[5]

A coercion-free operation that respects all its individuals reduces costs and prices, and thereby benefits consumers, including workers. The worker who wins in a collective-bargaining war may benefit temporarily but soon needs higher wages again because lack of productivity reduces his own purchasing power. Those outside the direct scope of the bargaining war are the real victims: "Here, as is always true in war, the civilian population is overrun and suffers more than the armed forces involved in actual combat. There is no

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

protection for the innocent bystanders in war or in the Wagner Act. . . . As the costs of the standard of living go up and jobs decrease, as they must, unrest is sure to develop. Those at the bottom of the economic ladder suffer first. Shortly thereafter, all are involved. Government then steps in, as it must under the present philosophy of government, as a provider of a standard of living for the unfortunate. This still further upsets the economic machine, and we have still higher costs because of the increased taxes and governmental interference. There are hence still fewer jobs, more government help to the needy, and hence still more need."[6]

"The essential for success is cooperation," he wrote.[7] An orphanage can efficiently feed, clothe, and house children and may even exceed parents' abilities in those respects. But it does not succeed in rearing children as well as the home does because "the essential that is left out is the friendly cooperation that is obtained in the successful family. This cooperation cannot be commanded, it must be spontaneous. It cannot be a matter of law, it must be a matter of desire."[8]

Lincoln foresaw in 1946 that government-mandated coercion in the labor arena would deteriorate American manufacturing competitiveness and price the nation out of significant world markets. In his last two books he acknowledged the intellectual debt he owed to Rose Wilder Lane and Dr. Frank Halliday Ferris. His company has remained successful by continuing to adhere to his principles, despite the obstacle of ever-greater encroachment of government into workplace relations. □

1. James F. Lincoln, *Lincoln's Incentive System* (New York: McGraw-Hill Book Company, Inc., 1946), p. 95.
2. Ibid., p. 38.
3. *New York Times*, June 24, 1965, p. 35.
4. Ibid.
5. Lincoln, pp. 95, 97.
6. Ibid., pp. 98–99.
7. Ibid., p. 103.
8. Ibid., p. 101.

Inspired? Shocked? Delighted? Alarmed?

Let us know.

We will print the most interesting and provocative letters we receive regarding *Freeman* articles and the issues they raise. Brevity is encouraged; longer letters may be edited because of space limitations. Address your letters to: *The Freeman*, FEE, 30 S. Broadway, Irvington-on-Hudson, New York 10533; e-mail: freeman@fee.org; fax (914) 591-8910.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

Withholding the Taxpayer Hostage

by Donald J. Boudreaux and Andrew P. Morriss

How often have you heard people say with pleasure, "I got a tax refund this year!"? Americans have grown so immune to income-tax withholding that many people regard IRS refunds as gifts. Misperceptions about withholding are widespread. In fact, withholding is a regressive, costly, and furtive system for collecting taxes.

Fifty-six years ago Congress approved the current system under which a sum is withheld from each paycheck and deposited with the government, with taxpayers and the government settling accounts once a year when tax returns are filed. According to Milton Friedman, who helped create the withholding system as a young economist in the Tax Research Division during World War II, withholding was justifiable during the war because it raised revenue for the war effort that could not have been raised otherwise.

Is Withholding Justified?

What justifies withholding during peacetime? Withholding is said to have three advantages over a system in which taxpayers pay their tax bills annually in one lump sum. First, withholding guards against the threat that people will have too little money on hand to pay their taxes. Some congressmen even argued in 1942 that withholding was necessary to protect taxpayers from loan sharks at tax time! Second, because it reduces current disposable income, withholding is said to be anti-inflationary. Third, withholding smoothes the government's revenue stream, making government spending simpler.

None of these goals requires that employees who have taxes withheld not be compensated for lost interest. The government could do this simply by paying interest on the money withheld. This is not a new idea. In 1912, the federal government experimented with interest-bearing tax-anticipation notes; the secretary of the Treasury sold the first note to President Teddy Roosevelt. Flaws in the design of these notes doomed them to failure, but the principle remains correct—early payment of taxes ought to be compensated by the payment of interest.

Expensive and Regressive

Withholding costs taxpayers a great deal of money. With some back-of-the-envelope calculations based on IRS data, we estimate that since its inception in 1943 withholding has taken over $400 billion (calculated in 1995 dollars) in interest from taxpayers. In a single year withholding costs the average worker over $100 in forgone interest.

Not surprisingly, withholding also unfairly penalizes wage income relative to non-wage income. Consider two couples, Ted and

Donald Boudreaux is president of the Foundation for Economic Education. Andrew Morriss is professor of law and associate professor of economics at Case Western Reserve University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Tammy Toiler and Pierre and Priscilla Plutocrat. Both couples have annual federal tax liabilities of $10,000, and both structure their withholding and estimated tax payments so that they legally minimize the amounts they pay to the IRS before April 15. The only difference between these couples is that the Toilers just have wage income and the Plutocrats live exclusively on investment income. Thus the Toilers have taxes withheld from their biweekly paychecks while the Plutocrats make four estimated tax payments a year. Using a 4 percent interest rate, at the end of the year the Toilers' lost interest from withholding (about $273) is 17 percent higher than the Plutocrats' lost interest (about $234). This disparity in tax treatment is caused by the government's holding more of the Toilers' money for a longer time than it holds the Plutocrats' money.

Such disparities are rampant in our tax system. Procedural quirks and unintended consequences result in radically different tax rates for similar amounts of income based on the source, the taxpayer, and, for all we know, the phases of the moon. There is no rational basis for applying a higher implicit tax to wage income than to non-wage income. A business that behaved in a like fashion, randomly charging some customers higher prices for example, would quickly go out of business. The great "advantage" of government for the tax and spend crowd, of course, is that it short-circuits the market forces which penalize irrational behavior by private businesses.

Deceived Taxpayers

The withholding tax is also a potent cause of fiscal illusion among taxpayers. Rather than write an annual check to the government for the full amount of their tax bills, most taxpayers on April 15 either send in a claim for a refund or pay only a small fraction of their taxes. In his 1989 book, *A Law Unto Itself: Power, Politics and the IRS*, David Burnham recounts a Harvard Medical School faculty member's confession that he hardly notices his paycheck deductions. Burnham reports that accountants and tax lawyers now find that large numbers of taxpayers no longer view the IRS "as a hard-nosed tax collector" but rather as "a benevolent bureaucracy that gives away money to the needy middle class." Thus, because taxpayers have become immune to the full magnitude of the tax bite, government growth is greater than it would be if there were no withholding or if withholding were less clandestine.

A Proposal for Reform

The best plan would be to abolish the income tax altogether. Until we can do so, however, the government ought to pay interest on money withheld as well as on estimated tax payments from the date of deposit of these sums with the Treasury. Short-term T bills provide a market rate of interest that can be easily used; a few lines of computer code can perform the calculations necessary to credit this interest to the "Amount Withheld" boxes on the W-2 forms employees receive at the end of the year.

Moving one step further to cure the problem of the disguised cost of government is almost as easy. Employers can deposit withheld tax payments (income and Social Security) into interest-bearing tax escrow accounts from which the government can borrow at T-bill rates. These accounts could then be released to employees before taxes are due. The government would be assured that individual taxpayers have the funds available to pay their taxes, while taxpayers would experience the full cost of Washington's operations. Adoption of this proposal might significantly restrain the growth of government spending by erasing the fiscal illusion caused by the current withholding scheme.

Genuine fairness requires reform of the regressive and deceptive system of tax withholding. Championing reform of the existing withholding system promises to be a good first step for politicians who regard fairness as something other than a slogan for use in class warfare. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Economics

Opportunity Cost and Hidden Inventions

Few people think about opportunity cost as systematically as economists do, but all of us are constantly guided by the opportunity costs we face. If, as you are reading this article, you learn that someone a few blocks away is giving $1,000 to anyone who comes by, I predict with confidence that you will quickly stop reading because of the cost of continuing. Unfortunately, we commonly accept arguments that would make sense only if people ignore the opportunity costs of their decisions.

Hidden Inventions

A persistent claim is that in market economies where the profit motive reigns supreme, extremely valuable inventions are hidden to prevent their sale. Supposedly, if the inventions were available they would destroy the profits of big corporations by making their products obsolete. So these corporations buy up wonderful inventions to make sure we can't buy them.

That an amazing invention has never been found in some secret warehouse does nothing to reduce people's belief that such things exist; they're hidden, aren't they? The reality is that the opportunity cost of hiding a valuable invention is so great that inventions worth more than they cost are quickly made available. Hidden inventions exist only in economically uninformed imaginations.

Dwight Lee is Ramsey Professor of Economics and Private Enterprise Economics at the University of Georgia.

The Hidden Carburetor

A popular hidden-invention claim concerns a carburetor that would greatly increase the gas mileage of ordinary automobiles. Assume that while tinkering in your garage you develop a carburetor that allows the heaviest car to get 150 miles per gallon—your mileage may vary slightly, depending on how you drive. Would you hide this invention? Surely not, because the opportunity cost would be enormous. The cost would equal the amount someone would be willing to pay for the rights to the carburetor. And who would offer you a lot of money for your invention? When I ask students this question, the answer is, usually, a big oil company. When I ask next what the oil company would do with the carburetor, the answer is, invariably, hide it.

The trouble with this answer is that it assumes the oil company ignored its opportunity cost after buying the carburetor. Sure, if the carburetor were sold, the oil company would lose some gasoline sales. But if the carburetor proved socially valuable—costing less to produce and use than the cost of the gasoline saved—it would be profitable for the oil company to sell it anyway. Remember, with a patent the oil company could acquire a monopoly on the carburetor for 17 years and charge a price about equal to the amount the buyer saves in gasoline purchases (the present value of the savings over the life of the carburetor).

So even if only the oil company lost gas sales because of the carburetor, its revenues

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

would not be reduced and its profits would increase as long as producing the carburetor cost less than producing the gas it saves. Since some, probably most, of the lost gas sales would be those of other oil companies, the profits from making the carburetor available would be even greater.

Of course, once the carburetor was on the market the patent might not be enforced perfectly as competitors offer substitutes. In any event, the patent would eventually expire. Then competition would drive the carburetor price down to near the cost of production, and the oil company's profits might decrease. But trying to hide the carburetor would still be a mistake.

First, the immediate increase in profits the carburetor would generate for a few years could easily be far more valuable than the future profits lost. Second, if the oil company didn't make the carburetor available, some other company (not necessarily an oil company) surely would. Then the profits from oil sales would be lost anyway, without the offsetting profits from carburetor sales. There are real profit advantages in being the first to market a new product or invention: getting the immediate patent-protected profits and establishing a reputation for providing a quality product that is valuable after the patent has expired.

However, not all inventions that do amazing things get to market. For example, in the 1930s a Mr. Pogue invented the Pogue carburetor, which greatly increased mileage by heating and vaporizing the gas before it went into the combustion chamber. Unfortunately, the carburetor had a tendency to explode, so some of the improved mileage was straight up. This invention was more costly to use than it was worth, so there was no opportunity cost to "hiding" it.

Light Bulbs and Tires

Other inventions commonly claimed to be hidden are long-lasting light bulbs and tires. Indeed, light bulbs and tires can be made to last longer than most of those we buy. But the problem isn't that such products are hidden. For example, light bulbs can be made to last indefinitely by increasing the thickness of the filament inside. Unfortunately, the thicker filament requires a lot more electricity. So there's a tradeoff between durability and electricity usage, and the market responds to people's desire to make such tradeoffs in sensible ways. Light bulbs that are relatively easy to change do not last as long as those that are difficult to change, such as those in refrigerators and in high ceilings. Also, when it would be dangerous for lights to go out frequently, as in automobile headlights, the bulbs are built to last a long time.

Similarly, tires can be made to last longer, but they would be more expensive, less comfortable, and often less safe. The market responds to the tradeoff people choose among cost, comfort, safety, and durability, so the tires on the family car are not as rugged as the ones on heavy earth-moving equipment.

It should be pointed out that light bulbs and tires of all types last longer than they used to. Better ways of making economical light bulbs and safe, comfortable tires have been developed, and the opportunity cost of hiding those improvements in the form of forgone profits made sure they were brought to market.

Given the proliferation of new products and innovations in recent years, some of which threatened large and profitable companies like IBM and AT&T, it is hard to understand the persistent belief that valuable inventions are being hidden. If an economic system based on the pursuit of profit caused valuable inventions to be hidden, then great products unavailable to Americans should have been plentiful in the former Soviet Union, where profit didn't guide economic activity. But as everyone should realize by now, it has been the other way around. Wonderful products and innovations that Americans take for granted were unavailable in socialist economies.

This is not surprising. By suppressing profits, socialism reduces the opportunity cost of keeping new products out of the hands of the public, whether by design or by default. As long as we allow the pursuit of profits in the marketplace, the cost of hiding new socially valuable inventions will be so high that we don't have to worry that they will be hidden. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty

I Lost My Job—Can I Keep My Principles?

by Mark Reboul

I accidentally discovered a great party trick: Get laid off from your job, tell someone about it, listen to them decry capitalism, wait for them to observe that you're entitled to collect unemployment, and then tell them you'd really rather not.

It is incredible how indignant some people become when they hear me say that. They don't even ask why I might want to stay away from it. They just keep saying over and over again, "Mark, it's *your* money. Don't you understand, you're *entitled* to it. Your employers have been paying in for you for all the years you've been working, and now it's time for you to collect!"

If I give even a vague response like, "I don't want to deal with the government unless it's absolutely necessary to stay out of jail" or, "I really don't like filling out forms," they get madder and madder, not just as if they're dealing with a lunatic (someone who would throw away free money), but as if they're dealing with a "dangerous" lunatic—a revolutionary or something.

I skip the detailed responses, such as: I never asked the government to protect me, or, if they really wanted to help me out in an unemployed period, they would *not* have taxed my employer for this purpose and I would have gotten paid more, which I then could have saved myself or invested in private unemployment insurance—without any of the cost and aggravation of having the money run through bureaucrats' hands.

Welfare by Any Other Name

I wonder why people are so hot on collecting unemployment, but are still generally against collecting the type of welfare that the chronically unemployed receive. I think I paid in for that too. By the same logic. . .

Anyway, you get the picture.

Unfortunately, it's really hard to turn down the government's "favors" when they've enmeshed themselves in so much of the economy. If they nationalize the medical business, will I only go to black-market doctors? If they take over all business, will I choose black-market work—or homelessness—over having a job and a decent (but inconsistently principled) life?

My previous job, at a private university medical center, was largely supported by government grants. Come to think of it, I haven't moved out of my rent-stabilized apartment either. The low rent helps a lot at a time like this when I have no income.

Now I just need to find a new job soon enough that I don't have to think about compromising my principles to survive. It's impossible to be perfectly consistent, but I think it's better if you can always remain aware of your inconsistencies.

In any event, I don't judge anyone else. We all do the best we can. □

Mark Reboul is a computer programmer and musician who lives in New York City.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
Ideas On Liberty
APRIL 1999

The Battle For Diamond Head: A Case of Market Failure?

"Hawaii's great and beloved landmark . . . is too precious an asset to be sacrificed."
—*Honolulu Advertiser* editorial (1967)

Last month I addressed the theory of entrepreneurial error in conjunction with the year 2000 computer problem. This month I raise another issue dealing with the possibility of market failure: Should government protect a local landmark from commercial development? Are zoning laws and other building restrictions necessary in a free society to stop "greedy" speculators and "fast buck" promoters from creating "urban sprawl" and unsightly commerce?

Recently my family and I spent a few days in Hawaii. Walking along famed Waikiki Beach, I couldn't help noticing how a string of high-rise apartments and hotels halted abruptly along the Diamond Head shoreline. (See photo on the next page.)

The Story of Diamond Head

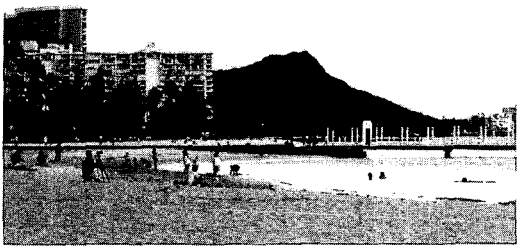
Why the sudden abatement? In the late 1960s Diamond Head was the center of a fierce debate between the developers and the conservationists. Following statehood in 1959, tourists flocked to this paradise of the Pacific, and Waikiki Beach, sandwiched between downtown Honolulu and Diamond Head, became the hottest real estate market for resort hotels and condominiums. Honolulu newspapers ran photos of a rapidly disappearing view of Diamond Head, and local citizens became alarmed. A grassroots organization, Save Diamond Head Association, was formed in 1967 and demanded a halt to building any more skyscrapers along the shoreline.

Why save Diamond Head? In the nineteenth century, British sailors found crystalline rocks on its slopes and mistook them for diamonds. Conservationists argue that Diamond Head is a symbol of paradise, the mid-Pacific's most famous beacon. One visitor wrote during the debate, "I found Diamond Head, which has been declared a state monument, in imminent danger of turning into a monument for the fast buck, its craggy profile threatened with disappearance behind a palisade of tall concrete buildings."[1]

Here's the conflict: Hawaii's natural beauty and delightful climate attracted millions of new tourists in the 1960s. The tourist boom in turn created a rush in real estate development. But the high-rise buildings—along with enormous billboards—were blocking out the natural beauty that attracted tourists in the first place. What to do?

*Mark Skousen (*http://www.mskousen.com*; mskousen @aol.com) is an economist at Rollins College, Department of Economics, Winter Park, FL 32789, a* Forbes *columnist, and editor of* Forecasts & Strategies.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Diamond Head today:
Should development have been halted?

The fight between the developers and environmentalists came to a head in December 1967. After a packed four-hour public hearing, five members of the nine-member city council voted against further commercial development. The other four members abstained. In 1968, Diamond Head was designated an official national landmark.

Is There a Market Solution?

Could the market properly plan for a growing Hawaii without destroying its natural beauty and aloha spirit, or must government intervene?

Sometimes the market faces a difficult choice between two conflicting goals. In the case of Diamond Head, it was the battle between development and a landmark symbol. Unfortunately, it's events like these that give capitalism a bad name. Could private developers have done better? Could it have been in their own self-interest to limit the height of hotels and condos and preserve Oahu's historic skyline while still making a profit? Can progress and profit go together?

What do free-market economists have to say about zoning and building codes? In *The Constitution of Liberty*, F.A Hayek notes that local governments have often done a poor job of city planning, sometimes amounting to "administrative despotism."[2] He cites rent controls, zoning regulations, and excessive taxation as examples. Nevertheless, he does support "some regulation of buildings permitted in cities," including minimum building codes.[3]

Economists have often been critical of zoning laws as an infringement of property rights. In a recent book on the subject, Tom Bethell asserts that zoning laws hurt the poor, cause urban sprawl, and invite political corruption. He points to Houston as an example of a dynamic city which has grown without zoning regulations.[4]

If conservationists really wanted to save Diamond Head, why didn't they buy the shoreline property and keep developers out? Instead of running to the City of Honolulu, Save Diamond Head Association should have raised the capital to stave off builders. Since 1953, Nature Conservancy, a nonprofit environmental organization with 900,000 members, has been buying and preserving land and habitats (now totaling over 10 million acres in the United States). Of course, such a plan would have been costly, with Waikiki property prices around $1 million an acre in 1967–68.

Property rights should include the right to be left alone from noise and air pollution. Should these rights also include the right of original owners to view Diamond Head? □

1. Kenneth Lamott, *Holiday Magazine*, July 14, 1967, quoted in Helen Geracimos Chapin, *Shaping History: The Role of Newspapers in Hawaii* (Honolulu: University of Hawaii Press, 1996), p. 268. Chapter 26 of Chapin's book, "Above Ground: The Battle for Diamond Head," summarizes the history of this conflict through the eyes of two local newspapers, the *Star-Bulletin* and the *Advertiser*.

2. F.A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), p. 355. Hayek devotes an entire chapter to "Housing and Town Planning," an area often ignored by economists.

3. Ibid., pp. 354–57.

4. Tom Bethell, *The Noblest Triumph: Property and Prosperity Through the Ages* (New York: St. Martin's Press, 1998), pp. 297–99.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

BOOKS

The Future and Its Enemies
by Virginia Postrel
The Free Press • 1998 • 265 pages • $25.00

Reviewed by George C. Leef

"At G.E., progress is our most important product." So ran the concluding line from dozens of General Electric ads from the 1960s. Back then, progress was *revered* in the United States. For the last few decades, however, there has been a rising tide of doubt. Today, we are more likely to hear hand-wringing lamentations over the destruction of the planet supposedly wrought by our exploitation of resources, or frightful predictions that technology is driving us headlong into dystopia. As the late Robert Nisbet wrote in *The History of the Idea of Progress*, "The skepticism regarding Western progress that was once confined to a very small number of intellectuals in the nineteenth century has grown and spread to not merely the large majority of intellectuals in this last quarter of this century, but to many millions of other people in the West."

The battle between those who want progress to continue and those who want to stop or even reverse it is the subject of this clarion call by *Reason* magazine editor Virginia Postrel. *The Future and Its Enemies* fills a desperate need. It's a book that illuminates the anti-progress philosophy (although that is too dignified a word) and tactics of, as she calls them, the "stasists." The inroads that the enemies of progress have been making in the United States should throw readers of this magazine into a cold sweat.

Stasists are not a homogeneous lot, but they all share a fear of change. Their camp includes violent technophobes like the Unabomber; "small is beautiful" intellectuals who pine for a simpler, more "natural" existence (not just for themselves, but for everyone); and opponents of particular innovations that might cause them losses—labor unions for instance. They are well funded, resourceful, and intent on locking in their view of the ideal world.

We have always had enemies of progress, but for most of American history, they couldn't really do anything except complain. Government had virtually no power to prevent individuals and firms from trying new products, technologies, and techniques. On the contrary, government power was committed to the defense of liberty and property rights. Coercive interference with others' experiments would land you in prison.

Jefferson warned, however, that the natural order of things is for liberty to yield and government power to gain. That has certainly been the case, especially in the last 70 years. As state power has grown, so has the ability of the stasists to put it to their ends, delaying or prohibiting changes that don't fit into their vision. Postrel correctly observes that the United States today "provides numerous opportunities for resourceful reactionaries: urban planning and endangered species laws to keep out Wal-Mart and new housing; environmental impact statements to limit business development and, if used by someone as clever as [Jeremy] Rifkin, to bar genetic engineering; Food and Drug Administration reviews to deter high-tech medical products . . . and on and on."

This constant growth of government has changed the rules of the game. People with new ideas can't just go ahead and give them a try. Often there is some board or commission whose approval must be obtained first. Even if not, we now have many vague statutes that provide cover for harassing lawsuits. Government power is of no use to innovators, but it means everything to the stasists, for the change they fear can only be halted by its use. Issuing scary manifestoes against, for example, biotechnology, won't stop it—but regulations and lawsuits can.

Postrel mentions Joseph Schumpeter's famous prediction that capitalism would collapse because of its very success, creating so much wealth and leisure that it would spawn a large class of idlers who would spend their time decrying its imperfections and destroying its foundations. Postrel puts a new twist

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

on Schumpeter's gloomy prediction. He feared the ascendancy of the *redistributionist* intellectual, but she shows that the greater menace is turning out to be the *anti-progress* intellectual.

But this isn't just an attack on the stasists. It is also a powerful argument in favor of the dynamic world-view. Postrel quotes Hayek's line that dynamism represents "the party of life, the party that favors free growth and spontaneous evolution," and then backs his assertion up.

If I have any criticism of this exceptional book, it is that the wake-up call isn't even louder and longer. It would have had a stronger impact had it gone into more detail on instances of stasist obstructionism. But of course, you can't say everything in a book. *The Future and Its Enemies* is, in my opinion, the most important book of the year. It needs to be widely read and discussed. □

George Leef is book review editor of The Freeman.

The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor

by David S. Landes

W.W. Norton & Company • 1998 • 650 pages • $30.00

Reviewed by Randall G. Holcombe

Economic historian David Landes explains in this book why some nations are rich and some poor by appealing to the historical record. The history is fascinating, and Landes does a good job of relating the facts.

His explanation of the wealth and poverty of nations is simple: rich nations are once-poor nations that developed market economies; poor nations are once- and still-poor nations that did not. Market economies require governments that do not interfere with people's economic affairs except to protect property rights. Landes builds his case by recounting the history of world economic development.

Landes maintains that western European, and especially British, culture is superior to others at promoting people's well-being. He makes the same case for the virtues of Protestantism. The Roman church found truths about nature in the scripture, so new ideas were potentially subversive. Protestant culture gave individuals more freedom to think for themselves, to innovate, and to keep the rewards of their successes. The notion that one culture is as good as another is wrong, Landes argues, at least if one judges a culture by its ability to enhance the well-being of its practitioners.

This is a big book, so as you might expect, his argument is far more involved than this. Landes notes that geographical factors played a large role in the patterns of development, and that some areas had advantages due to climate and natural resources that enabled them to develop sooner than others. But he also argues that geographical advantages, in the long run, can be disadvantages, because if wealth comes too easily, people do not have as much incentive to work hard and to use their wealth productively. When the Europeans began settling the Americas, for example, the Spanish and Portuguese gained easy wealth through territory rich in gold and silver, whereas the British territory required more work and investment. That investment, however, produced a much greater long-run payoff. Similarly, Landes argues that the oil-rich countries in the Middle East today are squandering their wealth because they came by it too easily.

The same argument applies to the industrialization of Britain, which had some natural advantages, such as coal deposits, but lacked others and in any event could capitalize on its advantages only by hard work and innovation. Before the Industrial Revolution, many areas of the world were at least as wealthy as Britain and had developed at least as much scientific and technical knowledge. China, in particular, was far ahead of Britain in many respects, but the British had one crucial advantage over the Chinese—a culture that encouraged commerce, risk-taking, and innovation. The British culture produced the Industrial Revolution, and Landes argues that no place in the world was able to industrialize without British influence.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Landes's argument is generally convincing, but not entirely so. For example, he notes that the Japanese culture once lacked the work ethic of western Europe and was hampered by an institutional rigidity and isolationism similar to China's. But Japanese culture changed, permitting industrialization, economic growth, and wealth. Thus, culture is not unchangeable. Moreover, "religious" aspects of culture are not tied to particular religions. The Japanese adopted the Protestant work ethic without adopting the religion. Landes's view of culture appears tautological; the culture he champions really amounts to any one that leads to the adoption of market capitalism.

Europe was characterized by many governmental jurisdictions, creating an environment of intergovernmental competition, whereas China and Russia were vast regions without that competition. Landes notes this fact, but fails to see its importance. Is it not plausible that industrialization developed first in Europe because governments faced the prospect of losing people and capital to rival governments, thus tempering the rulers' interference with freedom? Culture has some explanatory power, but it shouldn't be regarded as the only factor determining the extent to which the market is free to work.

Landes's conclusion that the ultimate path to wealth is the adoption of a market economy is unassailable. Despite his questionable assertion that culture is the key determinant in the choice between the market and government domination, his book has much to offer in its recounting of the history of world economic development and its insights on the differences among nations and cultures. □

Randall Holcombe is DeVoe Moore Professor of Economics at Florida State University.

From Wealth to Power: The Unusual Origins of America's World Role

by Fareed Zakaria

Princeton University Press • 1998 • 199 pages • $29.95

Reviewed by Robert Higgs

Throughout history strong nations have often expanded beyond their borders, establishing military or trading outposts, exerting influence on other nations, and sometimes pushing out their own borders by subjugating neighboring peoples. The United States, which began as a union of 13 small states east of the Mississippi River, pushed to the Pacific and ultimately took control of extensive overseas territories, provides a clear example. For a quarter-century after the Civil War, however, the United States exhibited little interest in expansion, and that peaceful interlude seems anomalous to Fareed Zakaria, who finds it "a highly unusual gap between power and interests."

From Wealth to Power began as Zakaria's dissertation, and its origins still show, especially in the repetitious commentary on its theoretical underpinnings. Without these trappings, an already short book could have been even shorter with little loss of substance. Still, the author, managing editor of *Foreign Affairs* magazine, writes well, and readers will have no difficulty understanding his argument.

Zakaria regards his study as a contest between two theories of international relations. "Classical realism" asserts that a nation expands whenever it can. Rich nations have many resources, which they use as the means of expansion—for example, by supporting large armies engaged in foreign conquest. "Defensive realism" asserts that a nation seeks security rather than influence and therefore expands when it perceives an external threat. Rich nations expand only when threatened by potentially powerful aggressors. Zakaria tweaks classical realism to create what he calls "state-centered realism," positing that rich nations do not necessarily expand but do so only when their central governments have sufficient strength to extract from soci-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ety the resources required to support the expansion.

From 1865 to 1889, Zakaria argues, the U.S. central government had little strength. The executive branch, where foreign policy initiative normally resides, played second fiddle to Congress; and the state and local governments took responsibility for many more functions and took in much more revenue than the national government. In those circumstances the United States declined to act on numerous opportunities for foreign expansion. Of 22 cases considered by Zakaria, only six resulted in expansion, the most important of those being the acquisition of Alaska in 1867 and the beginning of the construction of a blue-water navy in the 1880s. In other words, our relatively weak government was a hindrance to those who wanted to spread American power globally.

By the 1890s, however, the national executive branch had begun to exert itself more forcefully vis-à-vis Congress and the states. That enhanced power gave rise to greater international expansiveness beginning as early as Benjamin Harrison's administration (1889–93) and culminating in Theodore Roosevelt's flaunting of his Great White Fleet. Between 1889 and 1908, of 32 cases considered as opportunities for foreign expansion, 25 resulted in expansion, the most important of those cases being the annexation of Hawaii and the taking of Puerto Rico, Cuba, and the Philippines from Spain in 1898.

Although Zakaria's argument is interesting and suggestive, it is less than compelling. Surely, to mention just one piece of conflicting evidence, the robustly expansionist administration of James K. Polk presided over a far weaker national government than did, say, Grover Cleveland (even in his first term, 1885–89). Nor will Zakaria's shaky command of economic history reassure readers. He makes a number of outright factual or conceptual mistakes, for example, asserting that the Civil War tariffs were reduced or eliminated after the war, and confusing the national government's debt with its annual budget deficit or surplus.

Zakaria views his study as representative of the "bringing the state back in" school of social studies. "Nations," he insists, "do not formulate and implement foreign policy and extract resources to those ends; governments do." He does not seem aware that some of us, backed by generations of intellectual forebears, have appreciated that reality and based our analysis on it for a long time.

Obviously, the ability of a central government to appropriate the requisite resources is a precondition for external expansion. But whether a nation-state *will* project force abroad depends on the dominant ideology of those who control the government. Classical liberals have always understood that limited government, peace, and free trade form a coherent policy assemblage. To sacrifice any one of those elements is to jeopardize the others. □

Robert Higgs is a senior fellow in political economy at the Independent Institute, a visiting scholar at Seattle University, and the editor of The Independent Review.

American Abundance:
The New Economic and Moral Prosperity

by Lawrence A. Kudlow

Forbes-American Heritage • 1997 • 212 pages • $22.95

Reviewed by William H. Peterson

Over the last 15 years, the U.S. economy has experienced a 3 percent real average rate of growth in gross domestic product (with only one minor recession), declining inflation, falling interest rates, and a stock market since 1982 that has increased in value sixfold in real terms.

Still, good times usually give rise to a cottage industry of pessimism. Browse through a bookstore or peruse the newsletters of some investment gurus and you will find chilling predictions of the imminent collapse of an economic house of cards.

Or you could read Larry Kudlow's *American Abundance*. This book is as robustly bullish as anything in the economic soothsaying literature.

Kudlow was one of Reagan's budget economists. These days he devotes his time to fre-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

quent TV appearances, always wisely and wittily defending the superiority of the free market, and to writings that blast gaping holes in the plans of the interventionists to improve our lives through increased government spending and control. He also serves as chief economist to an investment advisory group.

Surveying the economic landscape, he comes to some very optimistic conclusions about our future. Despite the obvious falsity of the notion that "the era of big government is over," Kudlow sees irresistible forces at work to advance America's market society. The era of the *growth* of big government may be over.

One reason for his optimism is the fact that over 40 percent of the population—almost the same number as in the work force—are in the stock market through employee stock ownership plans, brokerage accounts, bank deposit plans, IRAs, Keogh Plans, 401(k) plans, mutual funds, variable annuities, and other private retirement systems. Kudlow reasons that this "investor class," a vast and growing army of corporate owners, is bound to prevail on Washington and push it toward free-market policies.

Contrary to the predictions of Marx, the workers have become capitalists—owners of the means of production. In the contest between the invisible hand of the market and the clenched fist of Marxism, as Kudlow says, "It was Marxism that withered away."

The idea that spreading investment via pension plans will cause the masses to jettison their anti-capitalistic biases is appealing, but there are grounds for skepticism. The investment trend has been going on for decades, but where's the growing opposition to Social Security, Medicare, "public education," subsidies, import restrictions, rent control, and the rest? Most people are too ill informed to see the connection between government interventionism and the size of their portfolios.

Kudlow courageously calls for wiping out more than a trillion dollars of federal spending, including the abolition of the Environmental Protection Agency, the Commerce Department, and other worse-than-useless agencies. That certainly would be good, but I fear that instead of foreseeing gains in their investments from lower spending and interventionism, the typical American would fall for the rhetoric of the politicians and their spinmeisters that the sky would fall if we didn't continue squandering money on such follies.

Kudlow also sees a big plus in the great technological wave that has been sweeping the economy, boosting productivity (which he thinks is understated in official statistics). Thanks to revolutionary knowledge and information technology—microchips, microprocessors, cell phones, personal computers, fiber optics, bioengineering and so forth—we are entering a Second Industrial Revolution, he maintains.

There is no denying that technology has given the economy a tremendous surge and will probably continue to do so as long as we can keep the government from upsetting the apple cart. The forces of "green" reactionary statism dislike technological progress and will do everything they can to slow or stop it.

In the course of the book, Kudlow pays homage to several of the great economists of the twentieth century, including Ludwig von Mises, Joseph Schumpeter, F. A. Hayek, and Milton Friedman, whose philosophies, he believes, will help make the 21st century one of growth—both economically and morally. "We are in a period of great change and transformation," he writes. "Our evaporating inflation rate and our rising economic growth rate are mirrored in the phenomenal increase in the stock market, which is a metaphor for our times. We can look forward to improving social, spiritual values; an era of global peace and prosperity is upon us."

Whether Kudlow's optimism about America's future is warranted; whether American attitudes will move back toward individual liberty and free enterprise, only time will tell. Stay tuned. □

William Peterson, a Heritage Foundation adjunct scholar, is the Distinguished Lundy Professor Emeritus of Business Philosophy at Campbell University in North Carolina.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Africa in Chaos

by George B. N. Ayittey

St. Martin's Press • 1998 • 399 pages • $35.00

Reviewed by Mwangi S. Kimenyi

George Ayittey is one of a few African scholars committed to advancing the ideals of classical liberalism. This is clearly demonstrated in his previous books, *Indigenous African Institutions* and *Africa Betrayed.* In *Africa in Chaos*, Ayittey advances the arguments made in those books, provides a detailed report on the chaos in Africa, and proposes various reforms to deal with the crisis. It is an excellent chronicle of events that have led to the demise of civil society in Africa.

A clear indicator of the chaotic state of affairs is the economic condition of Africa. The continent—more specifically sub-Saharan Africa—is richly endowed with some of the most valuable natural resources. Its potential for economic growth is enormous, yet countries in this region have the lowest standard of living in the world. Malnutrition and even starvation are widespread. African countries rank lowest in all measures of economic well-being, such as the proportion of population below poverty, infant mortality, life expectancy, and caloric intake. Infrastructure, which includes government buildings, roads, railways, and telephone and electricity facilities, is in a sad state of disrepair. The evidence shows that political independence has not advanced the material well-being of Africans in general.

What explains this dismal condition? Ayittey's book provides a detailed account of government policies that stifle the functioning of markets. Instead of building on indigenous markets that prevailed in the past, African leaders adopted policies that involved heavy-handed intervention. The primary result of government intervention has been to undermine the incentive to produce. In many countries property rights are insecure and leaders often engage in arbitrary expropriation. While many Africans remain destitute, political allocation of resources has provided rulers with copious opportunities to get rich.

Another reason for Africa's economic crisis has been the mistaken belief that large modern projects are equivalent to progress. Supported by foreign governments and international organizations, numerous capital-intensive projects divert resources from consumer-driven purposes. Further contributing to the instability has been the reliance on the many public enterprises that are inefficient and largely dependent on subsidies.

But if political independence has done little to advance the material well-being of the majority of Africans, it has proven disastrous for their liberty. Ayittey demonstrates that independence in Africa has been characterized by some of the most oppressive governments in history. The first wave of civilian leaders adopted oppressive laws that prohibited political competition and empowered rulers to detain opponents without trial. These "leaders" were replaced in many instances by military officers who were even more corrupt and tyrannical. With every coup, things have usually gotten worse.

To compound the problems, many countries have experienced internal conflicts. Armed clashes such as those in Somalia, Zaire (Democratic Republic of Congo), Liberia, Uganda, Rwanda, Burundi, Angola, Sudan, and many others have resulted in millions of casualties. Internal conflicts are exacerbated by the fact that government is geared more to plunder than to protecting rights and keeping peace.

Ayittey is critical of the commonly proposed solutions to the crisis in Africa. He argues that foreign aid and loans such as those advanced by the international organizations have no benefit in the long run. Ayittey proposes reform policies that key on the restoration of civil and economic liberties, building on traditional African systems of governance.

In sum, *Africa in Chaos* is informative, well written, and rich in detail. This book advances our understanding of African institutions and should be particularly helpful to those "development experts" who prescribe policies to Africans and yet have limited understanding of the continent. □

Mwangi Kimenyi is associate professor of economics at the University of Connecticut.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Swimming Against the Tide

by Clarence B. Carson

American Textbook Committee • 1998 • 562 pages • $29.95

Reviewed by Norman S. Ream

No one who has regularly, or even periodically, read *The Freeman* for the past 40 years will be unacquainted with Clarence B. Carson. In this book, subtitled "Memoirs and Selected Writings," one can discern how Carson's philosophical position has developed through the years, from the time he departed his birthplace in Alabama, through his teaching career, and eventually to his connection with the Foundation for Economic Education.

The title of this volume is eminently appropriate, for all through those years he certainly was swimming against the tide of popular and academic opinion. Clarence Carson is a pithy opponent of all your standard left-wing fads and fantasies, but also finds himself in disagreement with some of his allies. His economic and political philosophy is firmly grounded in the moral and ethical principles the author derives from his Christian faith. Because of that faith, Carson takes issue with Ludwig von Mises and other heroes of the free-market movement for their purely secular defenses of private property and the market order. Agree or disagree, Carson stands his ground.

The first section of the book is purely autobiographical and may be a bit too detailed for the average reader. Born and educated in the South, with advanced degrees from Vanderbilt and Auburn, Carson spent the major period of his life teaching in several colleges. During his early education he had moved toward what is today called "liberalism," but by the time he earned his Ph.D., his doctoral dissertation was titled "Embattled Individualists: The Defense of the Idea of Individualism, 1890–1930."

Although Carson was a college professor by vocation, he was mainly interested in writing and has published over 19 books, many of them designed to be textbooks. Three of his books, *Basic Economics, Basic Communism,* and *Basic American Government* have been main selections of the Conservative Book Club. His six-volume *A Basic History of the United States* is certainly his magnum opus; it is an excellent survey of American history without, of course, any hint of the common leftist biases.

Carson began contributing to *The Freeman* in 1961. Forty of his articles became a book entitled *The World in the Grip of an Idea.* The author describes it as follows:

> I believed that in my studies and writing I had reached a plateau above and beyond the ideologies of the 19th century which had fueled the conflicts of this century. I saw, or believed I saw, the underlying similarities and failings of these ideologies. I saw those things about Communism, Fascism and gradualist socialism. But I believed I saw the role and weaknesses of corporate capitalism as well. . . . What all these ideologies had in common was the justification of the use and abuse of organizations to control men's minds and actions to their own ends. Every one of these collectivisms fails to grasp the fact of the superiority of the individual in all constructive activity and fails to understand that collectives are only superior in the use of destructive force on individuals.

Most of Carson's wide-ranging memoir is taken up with stories, essays, articles, philosophical musings, economic ruminations, and more. A brief sampling: "The Constitution of Paper Money," "The Dilemmas of Public Education," and "Beyond the Christmas Story."

The author has strong opinions and deep convictions. As noted, he objected to Mises's secularism. Yet perhaps surprisingly, he includes a fine memorial to Ayn Rand.

The book has its weaknesses. The autobiographical section was not adequately edited and contains numerous errors of punctuation and sentence structure. Also, the volume would have benefited from an index. Still, *Freeman* readers old and new will find a lot of provocative and enjoyable writing in this book. □

Norman Ream, a long-time Freeman *contributor, is a retired minister living in Estes Park, Colorado.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Taxman Cometh!

T.S. Eliot was right: April really is the cruelest month, and not because of its wrenching mix of memory and desire but, instead, because of the discouraging annual ritual of filling out our 1040 forms. Rather than calling to mind "chestnuts in blossom," thoughts of April are much more likely to focus on hours hunched over our desks, desperately sorting receipts. Although we may (for now) be stuck with the Byzantine system, this doesn't mean we can't rail against it. This month's sale offers books that investigate taxation and money. We hope they'll provide relief from the stresses and strains of tax preparation.

What Has Government Done to Our Money? by **Murray Rothbard**, 4th ed.

Bad enough that one quarter to forty percent of our incomes are taken in taxes, but to add insult to injury, the people in charge of the money supply often debase it by turning the printing presses on full steam. This small book discusses why groups of people come to rely on money – rather than cows, for example – as a medium of exchange. After considering what a free market in money might entail, Rothbard discusses the many ways in which government officials meddle with money. Finally, he investigates how the international gold standard of the 19th century broke down in the wake of the Great War. Very interesting from both a historical and theoretical perspective.

119 pages, paper $7.95 **Sale: $4.00**

Taxation and Confiscation, a *Freeman Classic*

This anthology of articles provides an excellent overview of the general issue of taxation. Taxes may be used as the means to a number of different ends: filling the purses of the politically powerful, redistributing income to achieve some alleged equity, or encouraging or discouraging some particular behavior (sin taxes). These articles examine taxation as a means to the ends of social justice and social reform. Tax rates have an important impact upon what is produced and when. Five essays look at this problem. Finally, a number of essays discuss taxation as a destructive force. This is a lucid investigation of an issue intimately connected to liberty.

206 pages, paper $12.95 **Sale: $6.00**

Death & Taxes by **Hans F. Sennholz**

Should people's property be taxed at their death? Presumably, the property was taxed at least once during their lifetime, so why should these assets be taxed again? This book takes a brief general look at taxes and the justifications offered for their continuation. Focusing on estate taxes, Dr. Sennholz investigates the claim that death taxes are a wealth equalizer. He looks at the effects such taxation has on predecessors and successors, why people avoid these taxes, and how trusts minimize tax burdens. The volume concludes with suggested reforms.

105 pages, paper $5.95 **Sale: $3.00**

Special Offer for April Orders!! Order any book on sale this month and we'll waive normal postage charges! Mail orders to: FEE, 30 S. Broadway, Irvington-on-Hudson, NY 10533; call 914.591.7230 or fax 914.591.8910. We accept Visa, MC, Discover and American Express ($10 minimum on credit cards).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

What American Education Needs

For over four decades the public education establishment has delivered one educational disaster after another. "Solution" after "solution" has fallen far short of promises. The education establishment's perennial answer to our education problems is more money. Educational expenditures have skyrocketed (more than doubling every 20 years since 1960) and yet SAT scores plummet.

National Assessment of Education Progress (NAEP) test results partially demonstrate our dismal education picture. Of 17-year olds taking the test: 47 percent could not express 9/100 as a percent; only 5 percent could calculate the cost per kilowatt on an electric bill that charged $9.09 for 606 kilowatts; 26 percent did not know the U.S. Congress was part of the legislative branch of government; 43 percent of high school juniors could not place World War I within the period 1900 to 1950; 75 percent could not place Abraham Lincoln's presidency in the era 1840–1880.[1]

The education establishment's latest "solution," supported by President Clinton, is massive federal expenditures to hire 100,000 additional teachers. This they claim will reduce class sizes and thus improve academic performance. The United States already has smaller classes than countries where student academic performance is much greater than ours. For example, Japan averages 41 students per class compared to 26 in the United States. In mathematics, where their students run circles around ours, their average math class size is 43 compared to our 20.[2]

Breaking the education monopoly will solve most of the nation's education problems. A way to achieve this is through education vouchers or tuition tax credits. With education vouchers, state and local governments make direct payments to parents, in the form of vouchers that are used to pay tuition at public or nonpublic schools.

Tuition tax credits give parents a credit against their income taxes for tuition expenses. For example, if parents spent $3,000 in tuition to send their kid to a nonpublic school, all or a percentage of the tuition would be subtracted from their tax liability. Tuition tax credits are far preferable to vouchers because we would not run the risk of government intervention in the form of state Departments of Vouchers.

Opponents interested in maintaining the monopoly of education have advanced arguments against greater competition in the education of America's children. These arguments seem to be plausible; however, upon a little reflection they are simply baseless.

If a voucher or tuition tax system is instituted, public schools will be destroyed. This charge amounts to a tragic confession that public schools are so inferior that given a choice, all parents would opt out. The fact of the matter is some public schools are doing a satisfactory job; those schools would survive. Schools doing a poor job would have to either improve or perish.

Walter Williams is the John M. Olin Distinguished Professor of Economics and chairman of the economics department at George Mason University in Fairfax, Virginia

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

If there is a voucher or tuition tax credit system, private schools would skim off the best students leaving public schools with the least motivated students. Assume for a moment this might happen. To object to parental choice for that reason is callous arrogance and cruelty. It differs little from saying that parents who want better education prospects and a brighter future for their children should be held hostage until some undetermined time when public schools have improved. While the education establishment is willing to hold parents hostage, they want choice for themselves. Public school teachers enroll their own children in nonpublic schools to a much greater extent than the general public.

Vouchers or tax credits will lead to school racial segregation. Most voucher and tuition tax proposals prohibit racial discrimination. The major thrust for school choice programs has come from black parents, most likely to be served by poor schools. Moreover, most large city public schools are already racially homogeneous. For example, in Manhattan, public schools are nearly 90 percent black or Hispanic, while private schools are 80 percent white. While there is a smaller overall percentage of blacks in private schools, private schools are more racially heterogeneous. Therefore, if racial diversity is deemed desirable, school choice would contribute to that goal.

Even if school choice is a good idea, there are not enough nonpublic schools. This is an absurd criticism and reflects ignorance of markets. In the 1970s, there were no computer software stores and few video rental shops. Would you have argued back then that the manufacturing and marketing of computers and VCR machines should be held up until software and rental shops were in place? Consumers having purchased computers and videos created the demand for those shops. We would expect the same with private schools. If parents had vouchers or tax credits, one can rest assured that entrepreneurs, in the pursuit of profits, would emerge to meet the demand for private schools.

Parents, particularly those who are low-income, are incapable of making wise choices. This is a demeaning attitude toward the poor and it also reflects ignorance of how markets operate. People have little direct information about the quality of most goods and services they use. They depend on indirect information such as word of mouth, consumer reports, advertisements, and so forth. I know that Lafite-Rothschild is an excellent Bordeaux not because of my wine-tasting skills but because of the testimony by others who spend their lives studying wine. Markets generate information about quality, and information would be generated about K through 12 schools just as markets already provide information about colleges and universities.

Even if parents made mistakes, it is inconceivable that parents, particularly black parents, could choose schools worse than the schools already serving them. On occasion I have put the matter more starkly saying that if the Grand Wizard of the Ku Klux Klan wanted to sabotage black academic excellence, he could not devise a more effective way of doing so than the schools serving most black children.

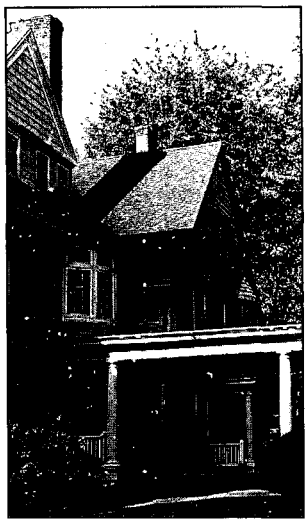
Education vouchers and tuition tax credits face another source of criticism. It comes from those fearful of government control of nonpublic schools through regulations that might accompany vouchers and tax credits. I share that concern and urge strong measures be taken to minimize that likelihood. The question I pose to these critics of vouchers and tuition tax credits is: which is the more serious and costly risk, that associated with the prospect of increased government intervention in nonpublic schools that might accompany vouchers and tax credits, or continued educational destruction of the nation's youngsters, particularly its black and Hispanic youngsters? □

1. William J. Bennett, *American Education: Making It Work* (Washington, D.C., April 1988), cited in *Making Government Work: A Conservative Agenda for the States,* ed., Tex Lezar (San Antonio: Texas Public Policy Foundation, 1992), p. 4.

2. Thomas Sowell, *Inside American Education: The Decline, the Deception, the Dogmas* (New York: Free Press, 1993), p. 12.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Austrian Economics Summer Seminar



for graduate students and faculty
July 6–16, 1999
in Irvington-on-Hudson, New York

co-sponsored by FEE and the Austrian Economics Program at New York University

Faculty for the seminar include:

- Professor Israel Kirzner, New York University
- Professor Roger Garrison, Auburn University
- Professor Mario Rizzo, New York University
- Professor Lawrence H. White, University of Georgia
- Professor David Harper, New York University
- Professor Peter Boettke, George Mason University

An intensive, rigorous academic seminar limited to about 35 participants. Successful applicants will receive a fellowship to cover tuition, meals, lodging, and study materials. Participants, however, will be responsible for travel expenses. Priority will be given to faculty members and graduate students who have not had the opportunity formally to study Austrian economics. Exceptionally well-qualified undergraduates are also encouraged to apply.

For complete application details, contact:

Peter J. Boettke, Austrian Economics Seminar
Department of Economics
George Mason University
4400 University Drive, MSN 364
Fairfax, VA 22030
telephone 703-993-1149; fax 703-993-1133
E-mail: boettke@gmu.edu

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

"The intelligent man, when he pays taxes, certainly does not believe that he is making a prudent and productive investment of his money; on the contrary, he feels that he is being mulcted in an excessive amount for services that, in the main, are useless to him, and that, in substantial part, are downright inimical to him."

—H. L. MENCKEN (1880–1956)

THE FOUNDATION FOR
ECONOMIC EDUCATION, INC.
30 South Broadway
Irvington-on-Hudson, NY 10533

Return service requested.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED